Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities

Published by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Legislative Proposals

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1. (1) Paragraph 12(1)(*k*) of the *Income Tax Act* is replaced by the following:

Foreign corporations, trusts and investment entities

(*k*) any amount required by subdivision i to be included in computing the taxpayer's income for the year;

(2) Subsection (1) applies to taxation years that begin after 2001 and to taxation years that begin after 2000 of a trust if the trust was created in 2001 and makes a valid election under paragraph 10(2)(*a*) of this Act.

2. (1) The definition "controlled foreign affiliate" in subsection 17(15) of the Act is replaced by the following:

"controlled foreign affiliate" « société étrangère affiliée contrôlée »

"controlled foreign affiliate" has the meaning that would be assigned by the definition "controlled foreign affiliate" in subsection 95(1) if this Act were read without reference to subsection 94.1(12) and if paragraphs (*d*) and (*e*) of that definition were read as follows:

"(*d*) one or more persons resident in Canada with whom the taxpayer does not deal at arm's length, or

(*e*) the taxpayer and one or more persons resident in Canada with whom the taxpayer does not deal at arm's length, and"

(2) Subsection (1) applies after 2001.

3. (1) Paragraph 39(1)(*a*) of the Act is amended by adding the following after subparagraph (ii.2):

(ii.3) a property in respect of which subsection 94.2(3) applies to the taxpayer immediately before the time of the disposition,

(2) Subsection (1) applies to dispositions that occur after 2001.

4. (1) Paragraph 53(1)(*d*.1) of the Act is replaced by the following:

(*d*.1) where the property is a capital interest of the taxpayer in a trust to which paragraph 94(1)(*d*) applied (as that paragraph read before 2002), any amount required by paragraph 94(5)(*a*) (as that paragraph read before 2002) to be added in computing the adjusted cost base to the taxpayer of the interest;

(2) Paragraph 53(1)(*m*) of the Act is replaced by the following:

(*m*) where the property is an offshore investment fund property (within the meaning assigned by subsection 94.1(1) as that subsection read before 2002),

(i) any amount included in respect of the property under subsection 94.1(1) (as that subsection read before 2002) in computing the taxpayer's income for a taxation year that began both before that time and before 2002, and

(ii) where the taxpayer is a controlled foreign affiliate of a person resident in Canada, any amount included in respect of the property in computing the foreign accrual property income of the controlled foreign affiliate because of the description of C in the definition "foreign accrual property income" in subsection 95(1) for a taxation year of the controlled foreign affiliate that began both before that time and before 2002;

(*m*.1) any amount required by subsection 94.1(9) or 94.2(11) to be added at or before that time in computing the adjusted cost base to the taxpayer of the property;

(3) Subsection 53(2) of the Act is amended by striking out the word "and" at the end of paragraph (*u*), by adding the word "and" at the end of paragraph (*v*) and by adding the following after paragraph (*v*):

(*w*) any amount required by subsection 94.1(9), 94.2(11) or 94.3(2) to be deducted at or before that time in computing the adjusted cost base to the taxpayer of the property.

(4) Subsections (1) to (3) apply after 2001.

5. (1) Subsection 70(3.1) of the Act is replaced by the following:

Exception

(3.1) In this section, "rights or things" in respect of an individual do not include an interest in a life insurance policy (other than an annuity contract where the payment for the contract was deductible in computing the individual's income under paragraph 60(*l*) or was made in

circumstances in which subsection 146(21) applied), eligible capital property, land included in the inventory of a business, a Canadian resource property, a foreign resource property or property in respect of which subsection 94.2(3) applied to the individual immediately before the individual's death.

(2) Subsection 70(5.2) of the Act is amended by striking out the word "and" at the end of paragraph (*c*), by adding the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*e*) if subsection 94.2(3) applies to the taxpayer in respect of a property at a time that is immediately before the taxpayer's death,

(i) the taxpayer is deemed to have, at that time, disposed of the property for proceeds of disposition equal to its fair market value at that time, and

(ii) any person who, as a consequence of the taxpayer's death, acquires the property is deemed to have acquired the property at that time at a cost equal to its fair market value at that time.

(3) Subsections (1) and (2) apply to the 2002 and subsequent taxation years.

6. (1) That portion of subsection 75(2) after paragraph (*b*) is replaced by the following:

any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, is, during the existence of the person while the person is resident in Canada (other than while the person is resident in Canada solely because of subsection 94(3)), deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.

(2) Subsection 75(3) of the Act is amended by striking out the word "or" at the end of paragraph (*c*.1) and by adding the following after paragraph (*c*.1):

(*c*.2) by a trust that is non-resident, for the purpose of computing its income for the year, because a contributor (within the meaning assigned by subsection 94(1)) to the trust is an individual (other than a trust) who was, at the end of the year, resident in Canada for a period of, or periods the total of which is, not more than 60 months; or

(3) Subsection (1) applies to taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the taxation year begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

(4) Subsection (2) applies to trust taxation years that begin after 2000, except that for trust taxation years that begin in 2001 paragraph 75(3)(*c*.2) of the Act, as enacted by subsection (2), shall be read as follows:

"(*c*.2) by a trust that is non-resident, for the purpose of computing its income for the year, because a contributor (within the meaning assigned by subsection 94(1) as it reads in 2002) to the trust is an individual (other than a trust) who was, at the end of the year, resident in Canada for a period of, or periods the total of which is, not more than 60 months; or"

7. (1) Paragraph 85(1.1)(*g*) of the Act is amended by striking out the word "or" at the end of subparagraph (ii) and by adding the following after subparagraph (ii):

(ii.1) a property held by the taxpayer if subsection 94.2(3) applies to the taxpayer in respect of the property, or

(2) Subsection (1) applies after 2001.

8. (1) Subsection 87(2) of the Act is amended by adding the following after paragraph (*j*.94):

Non-resident trusts and foreign investment entities

(*j*.95) for the purposes of sections 94 to 94.3, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(2) Subsection (1) applies after 2000.

9. (1) Subsection 91(1) of the Act is replaced by the following:

Amounts to be included in respect of share of foreign affiliate

91. (1) In computing the income for a taxation year of a taxpayer resident in Canada, there shall be included, in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer, as income from the share, the percentage of the foreign accrual property income of any controlled foreign affiliate of the taxpayer, for each taxation year of the affiliate that ends in the taxation year of the taxpayer, equal to the amount that would be that share's participating percentage in respect of the affiliate, determined at the end of each such taxation year of the affiliate if paragraph (*a*) of the definition "equity percentage" in subsection 95(4) did not take into account each share that would be subject to subsection 94.2(9) in respect of the taxpayer for the year if the taxpayer held the share throughout the year.

(2) Subparagraph 91(4)(*a*)(ii) of the Act is replaced by the following:

(ii) the taxpayer's relevant tax factor for the year, and

(3) Subsection (1) applies to taxation years that begin after 2001.

(4) Subsection (2) applies after 2001.

10. (1) Section 94 of the Act is replaced by the following:

Treatment of Trusts with Canadian Contributors

Definitions

94. (1) The definitions in this subsection apply in this section.

"arm's length transfer" « transfert sans lien de dépendance »

"arm's length transfer" at any time by an entity (in this definition referred to as the "transferor") means a loan or transfer of property (such loan or transfer referred to in this definition as the "transfer") made at that time by the transferor to a particular entity (in this definition referred to as the "recipient") where

(*a*) the transfer is a payment of interest, of a dividend, of rent, of a royalty or of any other return on investment, or any substitute for such a return on investment, in respect of a particular property held by the recipient, if

(i) the transfer is not a transfer described in paragraph 94(2)(*g*), and

(ii) the fair market value of the property, when transferred, is not more than the amount that the transferor would have transferred at that time in respect of the particular property to the recipient if the transferor had dealt at arm's length with the recipient;

(*b*) the transfer was a payment made by a corporation on a reduction of the paid-up capital in respect of shares of a class of its capital stock held by the recipient, if

(i) the transfer is not a transfer described in paragraph 94(2)(*g*), and

(ii) the amount of the payment is not more than the lesser of the amount of the reduction and the consideration for which the shares were issued;

(*c*) the transfer is such that

(i) the transfer was made in the ordinary course of the business of the transferor,

(ii) in exchange for the transfer, the recipient transfers or loans property, or becomes obligated to transfer or loan property, and

(iii) it is reasonable to conclude, having regard only to the transfer and the exchange, that

(A) the transferor would have been willing to make the transfer if the transferor had dealt at arm's length with the recipient, and

(B) the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor had the transferor dealt at arm's length with the recipient;

(*d*) the transfer is a refund in whole or in part of a gift that the recipient made to the transferor, if the recipient is a trust and the

transferor is at that time a specified charity in respect of the recipient; or

(*e*) it is reasonable to conclude that none of the reasons (determined by reference to all the circumstances including the terms of a trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the transfer was to permit or facilitate, directly or indirectly, the conferral at any time of a benefit on the transferor, a descendant of the transferor, or any entity with whom the transferor or descendant does not deal at arm's length, and

(i) in exchange for the transfer, the recipient transfers or loans property, or becomes obligated to transfer or loan property, and it is reasonable to conclude, having regard only to the transfer and the exchange that

(A) the transferor would have been willing to make the transfer if the transferor had dealt at arm's length with the recipient, and

(B) the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor had the transferor dealt at arm's length with the recipient,

(ii) the transfer

(A) is made in satisfaction of an obligation that arose because of a transfer to which subparagraph (i) applied, and

(B) is one that the transferor would have been willing to make if the transferor had dealt at arm's length with the recipient,

(iii) the transfer is a payment of an amount owing by the transferor under a written agreement the terms and conditions of which, when entered into, were terms and conditions that, having regard only to the amount owing and the agreement, persons dealing at arm's length would have entered into, or

(iv) the transfer is a payment made by the transferor to a trust (or to a specified person or partnership in respect of the trust) in repayment of or otherwise in respect of a particular loan made by the trust (or by the specified person or partnership) to the transferor if the particular loan was one into which the trust (or the specified person or partnership) and the transferor would have been willing to enter if the trust (or the specified

person or partnership) and the transferor had dealt at arm's length with each other, where "specified person or partnership" means

(A) a corporation controlled by the trust, or

(B) a partnership of which the trust is a majority interest partner.

"beneficiary"
« bénéficiare »

"beneficiary" of or under a trust includes

(*a*) an entity beneficially interested in the trust; and

(*b*) an entity that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under the trust to receive any of the income or capital of the trust either directly from the trust or indirectly through one or more entities (other than a corporation resident in Canada or a corporation a class of the shares of which is listed on a prescribed stock exchange).

"connected contributor"
« contribuant rattaché »

"connected contributor" to a trust at a particular time means an entity (including an entity that has ceased to exist) that is a contributor to the trust at the particular time, other than

(*a*) an individual (other than a trust) who was, at or before the particular time, resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including an individual who, before the particular time, was never non-resident); and

(*b*) an entity that would not be a contributor to the trust at the particular time if

(i) the transfers and loans referred to in paragraph (*a*) of the definition "contribution" made by the entity at a non-resident time of the entity were not taken into account,

(ii) the particular transfers and loans referred to in paragraph (*b*) of that definition made by the entity at a non-resident time of the entity were not taken into account, and

(iii) each obligation referred to in paragraph (*c*) of that definition arising at a non-resident time of the entity were not taken into account.

"contribution"
« apport »

"contribution" at any time to a trust by a particular entity means

(*a*) a transfer or loan made at that time of property (other than an arm's length transfer) to the trust by the particular entity;

(*b*) where a particular transfer or loan of property (other than an arm's length transfer) is made by the particular entity as part of a series of transactions or events that includes another transfer or loan of property that is made at that time to the trust by another entity, that other transfer or loan to the extent that it can reasonably be considered to have been enabled by the particular transfer or loan; and

(*c*) where the particular entity becomes obligated to make a particular transfer or loan of property (other than an arm's length transfer) as part of a series of transactions or events that includes another transfer or loan of property to the trust that is made at that time by another entity, that other transfer or loan to the extent that it can reasonably be considered to have been enabled by that obligation.

"contributor"
« contribuant »

"contributor" to a trust at any time means an entity (including an entity that has ceased to exist) that, at or before that time, has made a contribution to the trust.

"entity"
« entité »

"entity" includes an association, a corporation, a fund, an individual, a joint venture, an organization, a partnership, a syndicate and a trust.

"exempt foreign trust"
« fiducie étrangère exempte »

"exempt foreign trust" at a particular time means

(*a*) a non-resident trust, where

(i) each beneficiary of the trust at the particular time is

(A) an individual who, at the time that the trust was created, was, because of mental or physical infirmity, dependent on an individual who is a contributor to the trust or on an individual related to such a contributor (which beneficiary is in this paragraph referred to as an "infirm beneficiary"), or

(B) a person who is entitled, only after the particular time, to receive or otherwise obtain the use of any of the trust's income or capital,

(ii) at the particular time there is at least one infirm beneficiary who suffers from a mental or physical infirmity that causes the beneficiary to be dependent on any person,

(iii) each infirm beneficiary is non-resident at any time in the trust's taxation year that includes the particular time (in this definition referred to as the trust's "current year"), and

(iv) each contribution to the trust made at or before the particular time can reasonably be considered to have been, at the time that the contribution was made, made to provide for the maintenance of an infirm beneficiary during the expected period of the beneficiary's infirmity;

(*b*) a non-resident trust, where

(i) the trust was created after the breakdown of a marriage or common-law partnership of two individuals to provide for the maintenance of a beneficiary under the trust who is a child of one of those individuals (which beneficiary is in this paragraph referred to as a "child beneficiary"),

(ii) each beneficiary of the trust at the particular time is

(A) a child beneficiary under 21 years of age at the particular time,

(B) a child beneficiary under 31 years of age at the particular time who is enrolled at any time in the trust's current year at an educational institution that is described in clause (v)(A) or (B), or

(C) a person who is entitled, only after the particular time, to receive or otherwise obtain the use of any of the trust's income or capital,

(iii) each child beneficiary is non-resident at any time in the trust's current year,

(iv) each contributor to the trust at the particular time was one of those individuals or a person related to one of those individuals, and

(v) each contribution to the trust, at the time that the contribution was made, was made to provide for the maintenance of a child beneficiary, while the child was either under 21 years of age, or was under 31 years of age and enrolled at an educational institution located outside Canada that is

(A) a university, college or other educational institution that provides courses at a post-secondary school level, or

(B) an educational institution that provides courses that furnish a person with skills for, or improve a person's skills in, an occupation;

(*c*) a non-resident trust where

(i) at the particular time, the trust is an agency of the United Nations,

(ii) at the particular time, the trust owns and administers a university described in paragraph (*f*) of the definition "total charitable gifts" in subsection 118.1(1), or

(iii) at any time in the trust's current year or at any time in the preceding calendar year, Her Majesty in right of Canada has made a gift to the trust;

(*d*) a non-resident trust

(i) that, at all times at or before the particular time, would be non-resident if this Act were read without reference to subsection 94(1) as that subsection read before 2002,

(ii) that was created exclusively for charitable purposes and has been operated, throughout the period that began at the time it was created and ends at the particular time, exclusively for charitable purposes,

(iii) in respect of which, there is a group of at least 20 persons (other than trusts) at the particular time who are all contributors to the trust and who all deal with each other at arm's length, if the particular time is more than 24 months after the day on which the trust was created,

(iv) the income of which (determined in accordance with the laws described in subparagraph (v)) for each of its taxation years that end at or before the particular time would, if the income were not distributed and the laws described in subparagraph (v) did not apply, be subject to an income or profits tax in the country in which it was resident in each of those taxation years, and

(v) that was, for each of those taxation years, exempt under the laws of the country in which it was resident from the payment of income or profits tax to the government of that country in recognition of the charitable purposes for which the trust is operated;

(*e*) a non-resident trust that, throughout the trust's current year, is a trust governed by an employees profit sharing plan, a retirement compensation arrangement or a foreign retirement arrangement;

(*f*) a non-resident trust that, throughout the trust's current year, is governed by an employee benefit plan or is a trust (referred to in this paragraph as the "specified trust") described in paragraph (*a*.1) of the definition "trust" in subsection 108(1), where

(i) the plan or the specified trust is maintained primarily for the benefit of non-resident individuals in respect of services rendered outside Canada, and

(ii) if contributions have been made to the non-resident trust at or before the particular time in respect of services rendered by an employee while resident in Canada,

(A) the services were rendered outside Canada in connection with a business carried on by the employer outside Canada, or

(B) where clause (A) does not apply,

(I) the employee became a member of the plan (or another similar plan for which the plan was substituted), or became a beneficiary under the specified trust, before the end of the calendar month following the month in which the employee became resident in Canada, and

(II) in respect of each particular calendar month during which the services were rendered, the employee had been resident in Canada throughout no more than 60 of the 72 calendar months preceding the particular month;

(*g*) a non-resident trust that has, at all times since it was created, been

(i) operated exclusively for the purpose of administering or providing superannuation, pension, retirement or employee benefits,

(ii) maintained for the benefit of persons all or substantially all of whom are non-resident individuals,

(iii) resident in a country (other than Canada) under the laws of which an income or profits tax is imposed, and

(iv) exempt, under the laws of the country in which it was resident, from the payment of income tax and profits tax to the government of that country in recognition of the purposes for which the trust is operated;

(*h*) a non-resident trust that is, at the particular time, a trust described in paragraph (*c*) of the definition "exempt trust" in subsection 233.2(1), unless

(i) the trust was, because of subsection (3) (or subsection (1), as it read before 2002), deemed for a purpose of this Act to be resident in Canada in its last taxation year that ended before the particular time,

(ii) the trust has, by notifying the Minister in writing on or before its filing-due date for its taxation year that includes the particular time, elected to have this definition read without reference to this paragraph other than this subparagraph, for that taxation year and for all of its subsequent taxation years; and

(iii) throughout the period that begins at the beginning of the first taxation year to which the election applied and ends at the end of the trust's current year, all of the income of the trust for

each of those taxation years was payable in the year to a beneficiary under the trust; or

(*i*) a trust that is, at the particular time, a prescribed trust or included in a prescribed class of trusts.

"non-resident time"
« moment de non-résidence »

"non-resident time" of an entity in respect of a particular time means a time (referred to in this definition as the "contribution time") at which the entity made a contribution to a trust that is before the particular time and at which the entity was non-resident, where the entity was non-resident or not in existence throughout the period that began 60 months before the contribution time (or, if the entity is an individual and the trust arose as a consequence of the death of the individual, 18 months before the contribution time) and ends at the earliest of

(*a*) the time that is 60 months after the contribution time;

(*b*) if the entity is an individual, the date of death of the individual; and

(*c*) subject to subsection 94(11), the particular time.

"resident beneficiary"
« bénéficiaire résidant »

"resident beneficiary" at any time of or under a particular trust means an entity (other than an entity that is at that time a specified charity, or a testamentary beneficiary, in respect of the particular trust) that is, at that time, a beneficiary of or under the particular trust where, at that time

(*a*) the entity is resident in Canada; and

(*b*) there is a connected contributor to the particular trust.

"resident contributor"
« contribuant résidant »

"resident contributor" to a particular trust at any time means an entity that is, at that time, resident in Canada and a contributor to the particular trust but does not include

(*a*) an individual (other than a trust) who has not, at that time, been resident in Canada for a period of, or periods the total of which is, more than 60 months (other than an individual who, before that time, was never non-resident); or

(*b*) an individual, if

(i) the particular trust is an *inter vivos* trust that was created before 1960 by a person who was non-resident when the trust was created, and

(ii) the individual has not, after 1959, made a contribution to the particular trust.

"specified charity "
« organisme de bienfaisance déterminé »

"specified charity" in respect of a trust at any particular time is any person (in this definition referred to as the "charity") that at the particular time is a person described in any of paragraphs (*a*) to (*e*) and (*g*.1) of the definition "total charitable gifts" in subsection 118.1(1) other than

(*a*) a charity that does not, at the particular time, deal at arm's length with a specified entity in respect of the trust, and

(*b*) a charity that did not, at any specified prior time, deal at arm's length with a specified entity in respect of the trust,

where

(*c*) "specified prior time" in respect of a charity means any time, before the particular time, at which

(i) an amount was payable to the charity as a beneficiary under the trust,

(ii) an amount was received by the charity on the disposition of all or part of its interest as a beneficiary of or under the trust, or

(iii) a benefit was received or enjoyed by the charity from or under the trust, and

(*d*) "specified entity" in respect of a trust at any time means

(i) an entity that is at that time

(A) beneficially interested in the trust,

(B) a contributor to the trust,

(C) a person related to a contributor to the trust,

(D) a trustee of the trust,

(E) an entity that could reasonably be considered to have influence over the operation of the trust or the enforcement of its terms, or

(F) an entity that could reasonably be considered to have influence over the selection or appointment of an entity referred to in any of clauses (A), (D) and (E), or

(ii) any group of entities at least one of which is described in subparagraph (i).

"testamentary beneficiary"
« bénéficiaire testamentaire »

"testamentary beneficiary" at any time in respect of a trust means an entity that is a beneficiary of or under the trust solely because of a right, to receive income or capital of the trust, that arises on or after the death after that time of an individual who, at that time, is alive and

(*a*) is a contributor to the trust;

(*b*) is related to a contributor to the trust; or

(*c*) would have been related to a contributor to the trust if every individual who was alive before that time were alive at that time.

"treasury interest "
« participation de trésorerie »

"treasury interest" in a trust means an interest as a beneficiary of or under the trust that was issued by the trust for consideration.

Rules of application

(2) In this section,

(*a*) except where paragraph (*c*) applies, an entity is deemed to have transferred property to a trust when it transfers or loans property (other than by way of an arm's length transfer) to another entity if because of that transfer or loan

(i) the fair market value of one or more properties held by the trust increases at the time of the transfer, or

(ii) a liability or potential liability of the trust decreases at the time of the transfer;

(*b*) the fair market value of a property deemed by paragraph (*a*) to be transferred is deemed to be the total of all amounts each of which is the absolute value of an increase or a decrease referred to in paragraph (*a*) in respect of the property;

(*c*) an entity (in this paragraph referred to as the "transferor") is deemed to have transferred property to a trust when it transfers or loans property (other than by way of an arm's length transfer) to another entity (in this paragraph referred to as the "recipient") if

(i) at or after the time of the transfer, the trust holds property the fair market value of which is derived in whole or in part, directly or indirectly, from property held by the recipient, and

(ii) it is reasonable to conclude that one of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the transfer or loan was to permit or facilitate, directly or indirectly, the conferral at any time of a benefit on

(A) the transferor,

(B) a descendant of the transferor, or

(C) an entity with whom the transferor or descendant does not deal at arm's length;

(*d*) the fair market value of a property deemed by paragraph (*c*) to be transferred is deemed to be the fair market value of the property referred to in that paragraph that was actually transferred or loaned;

(*e*) if, at any time, an entity has given a guarantee on behalf of, or has provided any other financial assistance to, another entity, the entity is deemed to have transferred, at that time, property to that other entity;

(*f*) if, at any time after June 22, 2000, an entity (in this paragraph referred to as a "service provider") renders any service (other than an exempt service) to, for or on behalf of, another entity (referred to in this paragraph as a "recipient"), the service provider is deemed to have transferred, at that time, property to the recipient, where a service is an exempt service if

(i) the recipient is a trust and the service relates to the administration of the trust, or

(ii) the following conditions apply, namely

(A) the service is rendered in the service provider's capacity as an employee or agent of the recipient, and

(B) in exchange for the service the recipient transfers or loans property, or becomes obligated to transfer or loan property, and it is reasonable to conclude, having regard only to the service and the property, that

(I) the exchange is one that the service provider would have been willing to carry out if the service provider had dealt at arm's length with the recipient, and

(II) the terms and conditions made or imposed in respect of the exchange would have been acceptable to the service provider if the service provider had dealt at arm's length with the recipient;

(*g*) each of the following acquisitions of property by a particular entity is deemed to be a transfer, at the time of the acquisition of the property, to the particular entity from the entity from which the property was acquired, namely the acquisition by the particular entity of

(i) a share of the capital stock of a corporation from the corporation,

(ii) a beneficial interest in a trust (otherwise than as a consequence of a disposition of the interest by a beneficiary under the trust),

(iii) an interest in a partnership (otherwise than as a consequence of a disposition of the interest by a member of the partnership),

(iv) an interest in any other entity (otherwise than as a consequence of a disposition of the interest by an entity having an interest in the entity), and

(v) a debt owing by another entity from that other entity;

(*h*) a particular entity that grants at any time after June 22, 2000 to another entity a right to acquire or to be loaned property is deemed to have transferred property at that time to that other entity;

(*i*) the fair market value of property deemed by paragraph (*e*), (*f*) or (*h*) to have been transferred is deemed to be the fair market value, at the time of the transfer, of the assistance, service or right to which the property relates;

(*j*) a particular entity that at any time becomes obligated to do an act that would constitute the transfer of a property to another entity if the act occurred is deemed to have become obligated at that time to transfer property to that other entity;

(*k*) if an entity acquires property as a consequence of the death of an individual, the individual is deemed to have transferred property to the entity immediately before the individual's death;

(*l*) a transfer or loan of property at any time is deemed to be made at that time jointly by a particular entity and a third-party entity if

(i) the particular entity transfers or loans property at that time to another entity,

(ii) the transfer or loan is made at the direction, or with the acquiescence, of the third-party entity, and

(iii) it is reasonable to conclude that one of the reasons the transfer or loan is made is to enable the third-party entity (or an entity that does not deal at arm's length with the third-party entity) to avoid or minimize liability under paragraph (3)(*d*) in respect of any trust;

(*m*) a transfer or loan of property at any time is deemed to be made at that time jointly by a particular entity and a third-party entity if

(i) the particular entity transfers or loans property at that time to another entity,

(ii) the transfer or loan is made at the direction, or with the acquiescence, of the third-party entity,

(iii) that time is other than a non-resident time of the third-party entity, and

(iv) either

(A) the particular entity is, at that time, an entity that is a controlled foreign affiliate of the third-party entity, or would at that time be a controlled foreign affiliate of the third-party entity if the third-party entity were resident in Canada at that time, or

(B) it is reasonable to conclude that the transfer or loan was made in contemplation of the particular entity becoming after that time a particular entity described in clause (A);

(*n*) a contribution made at any time by a particular trust to another trust is deemed to have been made at that time jointly by the particular trust and by each entity that is a contributor at that time to the particular trust;

(*o*) a contribution made at any time by a particular partnership to a trust is deemed to have been made at that time jointly by the particular partnership and by each person or partnership that, at that time, is a member of the particular partnership (other than a member of the particular partnership where the liability of the member as a member of the particular partnership is limited by operation of any law governing the partnership arrangement);

(*p*) subject to subsection (9), the amount of a contribution to a trust at the time it was made is deemed to be the fair market value, at that time, of the property that was the subject of the contribution;

(*q*) an entity that at any time acquires a treasury interest in a trust, or a right to acquire one of those interests, from another entity (other than the trust that issued the treasury interest) is, unless the right has lapsed, deemed to have made at that time a contribution to the trust and the amount of the contribution is deemed to be equal to the fair market value at that time of the treasury interest; and

(*r*) an entity that has made a particular contribution to a trust as a consequence of having acquired a treasury interest in the trust, or a right to acquire one of those interests, is deemed, for the purpose of applying this section at any time after the time the entity transfers the treasury interest or the right to another entity (other than the trust), not to have made the particular contribution if

(i) in exchange for the transfer, the other entity transfers or loans property, or becomes obligated to transfer or loan property, to the entity, and

(ii) it is reasonable to conclude, having regard only to the transfer (or the obligation, as the case may be) and the property, that

(A) the exchange is one that entities dealing at arm's length with one another would have been willing to carry out, and

(B) the terms and conditions made or imposed in respect of the exchange are terms and conditions that would have been acceptable to entities dealing at arm's length with one another.

Application of subsection (2.2)

(2.1) Subsection (2.2) applies to an entity in respect of a trust if

(*a*) at any time property of a trust (referred to in this subsection and subsection (2.2) as an "original trust") is transferred or loaned, directly or indirectly, in any manner, to another trust (referred to in this subsection and subsection (2.2) as a "transferee trust");

(*b*) the original trust is deemed because of paragraph (3)(*a*) to be resident in Canada immediately before that time; and

(*c*) it is reasonable to conclude that one of the reasons the transfer or loan is made is to avoid or minimize the liability of any entity under this Act.

Deemed contributor

(2.2) An entity (including any entity that has ceased to exist) that, at the time of the transfer or loan referred to in subsection (2.1), was a contributor to the original trust is deemed to be

(*a*) a contributor to the transferee trust; and

(*b*) a connected contributor to the transferee trust, if at that time the entity is a connected contributor to the original trust.

Liability of deemed contributors

(2.3) In applying paragraph (3)(*d*) to determine the liability of an entity to which subsection (2.2) applies in respect of a transferee trust, this Act shall be read without reference to subsection (7).

Liabilities of non-resident trusts and others

(3) Where at the end of its taxation year a trust (other than a trust that is, at that time, an exempt foreign trust) is non-resident and, at that time, there is a resident contributor to the trust or a resident beneficiary under the trust,

(*a*) subject to subsection (4), the trust is deemed to be resident in Canada throughout the year for the purposes of

(i) computing the trust's income for the year,

(ii) section 2,

(iii) subsections (5) and (5.1), clause 53(2)(*h*)(i.1)(B), the definition "non-resident entity" in subsection 94.1(1), subsections 104(13.1) to (29), subsection 107(5), the definition "exempt property" in subsection 108(1) and sections 115, 233.3 and 233.4,

(iv) determining the rights and obligations of the trust under Divisions I and J, and

(v) determining the liability of the trust for tax under Part I, and under Part XIII on amounts paid or credited to the trust;

(*b*) for the purpose of section 126

(i) the trust's income for the year (other than the portion of the income that, if this Act were read without reference to this subsection, would be the trust's taxable income earned in Canada) is deemed to be income of the trust from sources in a country other than Canada in which the trust would, if this Act were read without reference to this subsection, be resident, and

(ii) the part of any income or profits tax paid by the trust for the year (other than any tax paid because of this section) that can reasonably be regarded as having been paid in respect of the amount determined under subparagraph (i) is deemed to be the

non-business-income tax paid by the trust to the government of that country;

(*c*) for the purpose of subsection 128.1(1), the trust is deemed to have become resident in Canada immediately after the end of its preceding taxation year if the trust

(i) was non-resident throughout that preceding year for the purpose of Part I or of computing its income for that preceding year, or

(ii) is deemed by subsection (5) or (5.1) to have ceased to be resident in Canada in that preceding taxation year; and

(*d*) subject to subsection (7), each entity that at any time in the year is a resident contributor to the trust or a resident beneficiary under the trust

(i) has jointly and severally, and solidarily, with the trust and with each other such entity, the rights and obligations of the trust in respect of the year under Divisions I and J and subsection 180.1(4), and

(ii) is subject to Part XV in respect of those rights and obligations.

Excluded provisions

(4) Paragraph (3)(*a*) does not apply for the purposes of

(*a*) subsection 73(1), paragraph 107.4(1)(*c*) (other than subparagraph 107.4(1)(*c*)(i)), paragraph (*a*) of the definition "mutual fund trust" in subsection 132(6), and subparagraph (*f*)(ii) of the definition "disposition" in subsection 248(1);

(*b*) determining the liability of a person that arises under section 215, except as the Minister otherwise permits in writing; and

(*c*) the definition "exempt foreign trust" in subsection (1).

Deemed cessation of residence

(5) A trust is deemed to have ceased to be resident in Canada at the earliest time at which there is neither a resident contributor to the trust nor a resident beneficiary under the trust in a period that would, if this Act were read without reference to this subsection and subsection 128.1(4), be a taxation year of the trust

(*a*) that immediately follows a taxation year of the trust throughout which it was resident in Canada;

(*b*) at the beginning of which there was a resident contributor to the trust, or a resident beneficiary under the trust; and

(*c*) at the end of which the trust is non-resident.

Deemed cessation of residence

(5.1) A trust is deemed to have ceased to be resident in Canada at the earliest time at which there is no resident contributor to the trust in a period that would, if this Act were read without reference to this subsection and subsection 128.1(4), be a taxation year of the trust

(*a*) that immediately follows a taxation year of the trust throughout which it was resident in Canada;

(*b*) at the beginning of which there was a resident contributor to the trust; and

(*c*) at the end of which the trust is non-resident or would be non-resident if this Act were read without reference to this section.

Becoming or ceasing to be an exempt foreign trust

(6) Where at any time a trust becomes or ceases to be an exempt foreign trust (otherwise than because of becoming resident in Canada),

(*a*) its taxation year that would otherwise include that time is deemed to have ended immediately before that time and a new taxation year of the trust is deemed to begin at that time; and

(*b*) for the purpose of determining the trust's fiscal period after that time, the trust is deemed not to have established a fiscal period before that time.

Limit to amount recoverable

(7) The maximum amount recoverable under paragraph (3)(*d*) at any time from an entity in respect of a trust and a particular taxation year of the trust is the entity's recovery limit at that time in respect of the trust and the particular year if

(*a*) either

(i) the entity is liable under paragraph (3)(*d*) in respect of the trust and the particular year solely because the entity was a resident beneficiary under the trust at the end of the particular year, or

(ii) at the end of the particular year, the total of all amounts each of which is the amount, at the time it was made, of a contribution to the trust before the end of the particular year by the entity, or by another entity not dealing at arm's length with the entity, is not more than the greater of

(A) $10,000 and

(B) 10% of the total of all amounts each of which was the amount, at the time it was made, of a contribution to the trust before the end of the particular year;

(*b*) except where the total determined in subparagraph (*a*)(ii) in respect of the entity and all entities not dealing at arm's length with it is $10,000 or less, the entity has filed on a timely basis under section 233.2 all information returns required to be filed by it before that time in respect of the trust (or on any later day that is acceptable to the Minister); and

(*c*) it is reasonable to conclude that each transaction or event that occurred before the end of the particular year at the direction of, or with the acquiescence of, the entity satisfied the following conditions:

(i) none of the purposes of the transaction or event was to enable the entity to avoid or minimize any liability under paragraph (3)(*d*) in respect of the trust, and

(ii) the transaction or event was not part of a series of transactions or events any of the purposes of which was to enable the entity to avoid or minimize any liability under paragraph (3)(*d*) in respect of the trust.

Recovery limit

(8) The recovery limit referred to in subsection (7) at a particular time of a particular entity in respect of a particular taxation year of a trust is the amount, if any, by which the greater of

(*a*) the total of all amounts each of which is

(i) an amount payable before the particular time to the particular entity (or another entity that was, at the time the amount became

payable, a specified party in respect of the particular entity) by the trust because of the interest of the particular entity (or of the specified party) as a beneficiary under the trust,

(ii) an amount (other than an amount described in subparagraph (i)) received or receivable before the particular time by the particular entity (or by another entity that was, at the time the amount became receivable by the particular entity, a specified party in respect of the particular entity) on the disposition of all or part of an interest as a beneficiary under the trust, or

(iii) the fair market value of a benefit (other than a benefit described in subparagraph (i) or (ii)) received or enjoyed by the particular entity (or by another entity that was, at the time the benefit was received or enjoyed, a specified party in respect of the particular entity) from or under the trust, and

(*b*) the total of all amounts each of which is the amount, when made, of a contribution to the trust before the particular time by the particular entity,

exceeds the total of all amounts each of which is

(*c*) an amount recovered before the particular time from the particular entity in connection with a liability of the particular entity arising under subsection (3) (or under subsection (1) as that subsection read before 2002) in respect of the trust and the particular year or a preceding taxation year of the trust, or

(*d*) an amount recovered before the particular time from a specified party in respect of the particular entity in connection with a liability of the particular entity arising under subsection (3) (or under subsection (1) as that subsection read before 2002) in respect of the trust and the particular year or a preceding taxation year of the trust, to the extent that the amount so recovered represents payment of a liability of the particular entity for an amount that is included in the total determined by paragraph (*a*).

Determination of contribution amount –special case

(9) In subparagraph (7)(*a*)(ii) and subsection (8), where a contribution is made at any time by an entity to a trust as a consequence of a transaction that is, or as a consequence of a series of transactions or events that includes, the transfer at that time to the trust of a specified property, the amount of the contribution at the time it is made, is deemed to be the greater of

(*a*) the amount, determined without reference to this subsection, of the contribution at that time, and

(*b*) the amount that is the greatest fair market value of the specified property, or property substituted for it, in the period that

(i) begins immediately after that time, and

(ii) ends at the end of the third calendar year that ends after that time.

Definitions – Subsections (8) and (9)

(10) The definitions in this subsection apply in this subsection and subsections (8) and (9).

"specified controlled foreign affiliate"

"specified controlled foreign affiliate" of a particular entity at any time means an entity that would, at that time, be a controlled foreign affiliate of the particular entity if the particular entity were resident in Canada at that time.

"specified party"

"specified party" in respect of a particular entity at any time means an entity that is at that time

(*a*) an individual who is a spouse or common-law partner of the particular entity;

(*b*) a specified controlled foreign affiliate of

(i) the particular entity, or

(ii) if the particular entity is an individual, a spouse or common-law partner of the individual; and

(*c*) an entity for which it is reasonable to conclude that the benefit referred to in subparagraph (8)(*a*)(iii) was conferred in contemplation of the entity becoming after that time a specified controlled foreign affiliate of an entity referred to in subparagraph (*b*)(i) or (ii).

"specified property"

"specified property" means

(*a*) a share of the capital stock of a corporation;

(*b*) a beneficial interest in a trust;

(*c*) an interest in a partnership;

(*d*) an interest in any other entity;

(*e*) a right to acquire property described in any of paragraphs (*a*) to (*d*); or

(*f*) any other property deriving its value primarily from property described in any of paragraphs (*a*) to (*e*).

Where contributor becomes resident in Canada within 60 months after contributing

(11) In applying the definition "connected contributor" at the end of each taxation year of a trust that ends before the particular time at which a contributor to the trust becomes resident in Canada within 60 months after making a contribution to the trust, the contribution is deemed to have been made at a time other than a non-resident time of the contributor if

(*a*) in applying the definition "non-resident time" as of the end of each of those taxation years, the contribution was made at a non-resident time of the contributor; and

(*b*) in applying the definition "non-resident time" at the particular time, the contribution is made at a time other than a non-resident time of the contributor.

(2) Subsection (1) applies to trust taxation years that begin after 2001, except that

(*a*) it also applies to taxation years that begin in 2001 of a trust if the trust was created in 2001 and elects, in writing, to have section 94 of the Act, as enacted by subsection (1), apply to those taxation years by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which this Act is assented to;

(*b*) the definition "contribution" in subsection 94(1) of the Act, as enacted by subsection (1), does not apply to

(i) a payment made before 2002 to a trust (or to a particular entity that, at the time the amount became payable to the particular entity, was a corporation controlled by the trust or was a partnership of which the trust was a majority interest partner) in satisfaction of any amount payable to the trust or to the particular entity; and

(ii) a payment made before 2005 to a trust or a particular entity in accordance with repayment terms agreed to before June 23, 2000 of a loan made by the trust (or by the particular entity that, at the time the loan was made by the particular entity, was a corporation controlled by the trust or was a partnership of which the trust was a majority interest partner);

(*c*) an election referred to in subparagraph (*h*)(ii) of the definition "exempt foreign trust" in subsection 94(1) of the Act, as enacted by subsection (1), made by a trust is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the trust's filing-due date for the taxation year of the trust that includes the day on which this Act is assented to;

(*d*) the phrase "if the entity is an individual and the trust arose as a consequence of the death of the individual, 18 months before the contribution time" in the definition "non-resident time" in subsection 94(1) of the Act, as enacted by subsection (1), shall, in respect of contributions made before June 23, 2000 be read as "if the contribution time is before June 23, 2000, 18 months before the end of the trust's taxation year that includes the contribution time"; and

(*e*) if a trust elects, by notifying the Minister of National Revenue in writing on or before its filing-due date for its taxation year that includes the day on which this Act is assented to, the definition "arm's length transfer" in subsection 94(1) of the Act, as enacted by subsection (1), does not include a loan or other transfer of property that is made before 2002 and identified in the election.

11. (1) Section 94.1 of the Act is replaced by the following:

Definitions

94.1(1) The definitions in this subsection apply in this section and sections 94.2 and 94.3.

"carrying value"
« valeur comptable »

"carrying value" at any time of property of an entity means

(*a*) the amount at which the property would be valued for the purpose of the entity's balance sheet as of that time if that balance sheet

(i) were prepared in accordance with generally accepted accounting principles used in Canada at that time or in accordance with accounting principles substantially similar to generally accepted accounting principles used in Canada at that time, and

(ii) included property that is deemed by subsection (10) to be owned at that time by the entity; or

(*b*) where the carrying value of the entity's property is relevant in determining whether an interest in the entity is a participating interest in a foreign investment entity of a taxpayer and the taxpayer elects to value all of the property of the entity at its fair market value by notifying the Minister in writing in the taxpayer's return of income for the taxpayer's taxation year that includes that time, the fair market value at that time of property the value of which would be determined under paragraph (*a*) if the taxpayer had not elected under this paragraph.

"entity"
« entité »

"entity" includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust, but does not include an individual (other than a trust).

"exempt interest"
« participation exempte »

"exempt interest" of a taxpayer in a foreign investment entity at any time means

(*a*) a participating interest held by the taxpayer at that time in a controlled foreign affiliate of the taxpayer;

(*b*) a participating interest that is at that time a mark-to-market property (within the meaning assigned by subsection 142.2(1)) of a taxpayer that is a financial institution (within the meaning assigned by subsection 142.2(1)) throughout its taxation year that includes that time;

(*c*) a participating interest of the taxpayer in a testamentary trust that, at or before that time, has never been acquired for consideration;

(*d*) a particular participating interest held by the taxpayer at that time in a foreign investment entity that is resident in a country in which there is a prescribed stock exchange if participating interests in the foreign investment entity that are identical to the particular participating interest are widely held and actively traded and listed on a prescribed stock exchange throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the particular participating interest, unless it is reasonable to conclude that the taxpayer had a tax avoidance motive for the acquisition of the particular participating interest;

(*e*) a participating interest held by the taxpayer at that time in a foreign investment entity if the foreign investment entity was a qualifying entity throughout the period, in the taxpayer's taxation year that includes that time, during which the participating interest was held by the taxpayer;

(*f*) a participating interest, held by the taxpayer at that time in a foreign investment entity, that is a right under an employee stock option, or similar agreement, to acquire a participating interest in the foreign investment entity if

(i) the right was granted by the foreign investment entity, or another entity with which it does not deal at arm's length,

(ii) the taxpayer acquired the right at a time when the taxpayer dealt at arm's length with the entity that granted the right, and

(iii) the taxpayer was entitled to acquire the right solely because the taxpayer was an employee of one of those entities;

(*g*) a participating interest held by the taxpayer at that time in a foreign investment entity all or substantially all of the carrying value of the property of which is attributable to properties that are

participating interests in another entity that is, or is related to, an entity that employs the taxpayer if

(i) all or substantially all of the income, profits and gains of the foreign investment entity for its taxation year that includes that time is allocated to its interest holders and the taxpayer's share of that income, profits and gains is included in computing the taxpayer's income for the taxpayer's taxation year in which that taxation year of the entity ends, or

(ii) the foreign investment entity allocates within 120 days after the end of its taxation year that includes that time, all or substantially all of its income, profits and gains for that taxation year to its interest holders and the taxpayer's share of that income, profits and gains is included in computing the taxpayer's income for the taxpayer's taxation year that includes the time at which the allocation is made;

(*h*) a particular participating interest held by the taxpayer at that time in a foreign investment entity that was formed, organized or continued under, and is governed by the laws of, a country (other than a prescribed country) with which Canada has entered into a tax treaty and that, under that treaty, is resident in that country if participating interests in the foreign investment entity that are identical to the particular participating interest are widely held and actively traded throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the particular participating interest, unless it is reasonable to conclude that the taxpayer had a tax avoidance motive for the acquisition of the particular participating interest; and

(*i*) a participating interest held by the taxpayer at that time in a foreign investment entity formed, organized or continued under, and governed by, the laws of a country (other than a prescribed country) with which Canada has entered into a tax treaty (referred to in this paragraph as the "treaty country") if

(i) the foreign investment entity is, under the tax treaty, resident in the treaty country throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest,

(ii) the taxpayer is resident in Canada throughout that period,

(iii) the taxpayer is liable for income tax in the treaty country for that taxation year because the taxpayer is a citizen of the treaty country, and

(iv) it is reasonable to conclude that the taxpayer did not have a tax avoidance motive for the acquisition of the participating interest.

"exempt taxpayer"
« contribuable exempté »

"exempt taxpayer" for a taxation year means

(*a*) an individual (other than a trust) who, before the end of the year, was resident in Canada for a period of, or periods the total of which is, not more than 60 months, but not including an individual who, before the end of the year, was never non-resident; and

(*b*) an entity the taxable income of which for a period any part of which occurs in the year is exempt from tax under this Part because of subsection 149(1) (otherwise than because of paragraph 149(1)(*q*.1), (*t*) or (*z*)).

"foreign bank"
« banque étrangère »

"foreign bank" has the same meaning as in subsection 95(1).

"foreign investment entity"
« entité de placement étrangère »

"foreign investment entity" at any time means an entity that is, at that time, a non-resident entity unless, at the end of its taxation year that includes that time

(*a*) it is a partnership;

(*b*) it would be an exempt foreign trust (within the meaning assigned by subsection 94(1)) if the definition "exempt trust" in subsection 233.2(1) were read without reference to paragraph (*c*) of that definition;

(*c*) it is a personal trust other than a non-discretionary trust;

(*d*) the carrying value of all of its investment property is not greater than one-half of the carrying value of all of its property; or

(*e*) its principal business is not an investment business.

"investment business"
« entreprise de placement »

"investment business" of an entity in a period means a business carried on by the entity (or the entity as a member of a partnership) at any time in the period the principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar return on investment or any substitute for such a return), income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of indebtedness or properties described in any of paragraphs (*a*) to (*d*) or (*f*) to (*l*) of the definition "investment property", unless it is established that, throughout the part of the period during which the business was carried on by the entity (or the entity as a member of a partnership other than as a member that would be a specified member of the partnership if the definition "specified member" of a partnership in subsection 248(1) were read without reference to paragraph (*a*) of the definition), the business (other than any business conducted principally with persons with whom the entity does not deal at arm's length) is

(*a*) a business carried on by the entity as a foreign bank, a trust company, a credit union or an insurance corporation, the activities of which are regulated under the laws

(i) of the country under whose laws the entity was formed, organized, continued or exists and is governed and of each country in which the business is carried on,

(ii) of the country in which the business is principally carried on, or

(iii) if the entity is a corporation that is controlled by another corporation, of the country under whose laws the controlling corporation is formed, organized, continued or exists and is governed, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union;

(*b*) a business carried on by an entity as a trader or dealer in securities or commodities where the entity is controlled by a taxpayer resident in Canada that is described in subparagraph 95(2.1)(*a*)(i) and the activities of the business are regulated under the laws

(i) of the country under the laws of which the entity was formed, organized, continued or exists and is governed and of each country in which the business is carried on,

(ii) of the country in which the business is principally carried on,

(iii) if the entity is a corporation that is controlled by another corporation, of the country under whose laws the controlling corporation is formed, organized, continued or exists and is governed, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union;

(*c*) the development and exploitation of Canadian resource property, of foreign resource property, of timber resource property or of any combination of them;

(*d*) the leasing or licensing of property manufactured, produced, developed or purchased and developed by the entity or by another entity related to the entity;

(*e*) the sale of real estate developed by the entity or an entity related to the entity (or a partnership of which the entity or a related entity is a member other than where the entity would be a specified member if the definition "specified member" of a partnership in subsection 248(1) were read without reference to paragraph (*a*) of the definition);

(*f*) the rental of real estate held by the entity (or a partnership of which the entity is a member other than where such entity would be a specified member if the definition "specified member" of a partnership in subsection 248(1) were read without reference to paragraph (*a*) of the definition) if the management, maintenance, and other services in respect of the real estate are provided by the employees of the entity or of a corporation related to it (or a member of the partnership that held the real estate or a person related to one of those members); or

(*g*) a combination of businesses described in paragraph (*e*) or (*f*).

"investment property"
« bien de placement »

"investment property" of an entity does not include property that is used or held principally in a business other than an investment business carried on by the entity or by another entity related to the entity, but does include property that is

(*a*) a share of the capital stock of a corporation other than a share of the entity itself, a share of a corporation that is a qualifying entity that has a significant interest in the entity, a share of a corporation that is related to the entity or a share of a corporation that is a qualifying entity in which the entity has a significant interest;

(*b*) an interest in a partnership other than an interest in a partnership that is a qualifying entity in which the entity has a significant interest or an interest in a partnership that is a qualifying entity that has a significant interest in the entity;

(*c*) an interest in a trust other than an interest in a non-discretionary trust that is a qualifying entity in which the entity has a significant interest or an interest in a non-discretionary trust that is a qualifying entity that has a significant interest in the entity;

(*d*) an interest in any other entity other than an interest in another entity that is a qualifying entity in which the entity has a significant interest or an interest in another entity that is qualifying entity that has a significant interest in the entity;

(*e*) indebtedness other than indebtedness owing by an entity that is a qualifying entity that has a significant interest in the entity, indebtedness owing by an entity that is related to the entity or indebtedness owing by another entity that is a qualifying entity in which the entity has a significant interest;

(*f*) an annuity;

(*g*) a commodity or commodity future purchased or sold, directly or indirectly in any manner whatever, on a commodities or commodities futures exchange (except a commodity manufactured, produced, grown, extracted or processed by the entity or a person to whom the entity is related, otherwise than because of a right referred to in paragraph 251(5)(*b*), or a commodity future in respect of such a commodity);

(*h*) real estate;

(*i*) a Canadian resource property or a foreign resource property;

(*j*) currency;

(*k*) a derivative financial product (other than a commodity future to which the exception in paragraph (*g*) applies); or

(*l*) an interest, an option, or a right in respect of property described in any of paragraphs (*a*) to (*k*).

"non-resident entity"
« entité non-résidente »

"non-resident entity" at any time means

(*a*) a corporation or trust that is non-resident at that time; and

(*b*) any entity (other than a corporation or trust)

(i) formed, organized, continued or existing under the laws of a country other than Canada, and

(ii) governed at that time under the laws of a country other than Canada.

"participating interest"
« participation déterminée »

"participating interest" in an entity means

(*a*) where the entity is a corporation

(i) a share of the capital stock of the corporation, and

(ii) a property that, under the terms or conditions in respect of which or any agreement relating to which, is convertible into or exchangeable for or confers a right to acquire, directly or indirectly, a share of the capital stock of the corporation or a property the fair market value of which is determined primarily by reference to the fair market value of a share of the capital stock of the corporation;

(*b*) where the entity is a trust

(i) a beneficial interest in the trust, and

(ii) a property that, under the terms or conditions in respect of which or any agreement relating to which, is convertible into or exchangeable for or confers a right to acquire, directly or indirectly, a beneficial interest in the trust or a property the fair market value of which is determined primarily by reference to the fair market value of a beneficial interest in the trust; and

(*c*) in the case of any other entity, an interest in the entity or any property that, under the terms or conditions in respect of which or any agreement relating to which, is convertible into, is exchangeable for or confers a right to acquire

(i) an interest in the entity, or

(ii) a property the fair market value of which is determined primarily by reference to the fair market value of an interest in the entity.

"qualifying entity"
« entité admissible »

"qualifying entity" in a period means a particular entity all or substantially all of the carrying value of the property of which is, throughout the period, attributable to the carrying value of properties that are

(*a*) properties other than investment properties;

(*b*) participating interests in or debt issued by another entity that, throughout the portion of the period that the participating interests or debt are property of the particular entity, is

(i) an entity in which the particular entity has a significant interest, and

(ii) a qualifying entity or an entity the principal business of which is not an investment business;

(*c*) participating interests in or debt issued by another entity if, throughout the portion of the period that the participating interests or debt are property of the particular entity,

(i) the particular entity

(A) actively participates in or exercises significant influence over the governance or the management of that other entity, directly or indirectly, by reason of its status as a holder of a significant number of participating interests in that other entity or by reason of an agreement in writing between the particular entity and one or more other holders of a significant number of participating interests in that other entity, or

(B) carries out a plan of action that it has established for the purpose of obtaining its objective of actively participating in or exercising significant influence over the governance or the management of that other entity, directly or indirectly, by reason of its status as a holder of a significant number of participating interests in that other entity (when compared to the number of participating interests held by each other holder of interests in the particular entity) or by reason of an agreement in writing between the particular entity and one or more other holders of a significant number of participating interests in that other entity, and

(ii) that other entity is a qualifying entity or an entity the principal business of which is not an investment business; or

(*d*) other investment property where the particular entity establishes that the property or proceeds from the disposition of the property is to be used by the entity for the purpose of acquiring property described in any of paragraphs (*a*) to (*c*).

"taxation year"
« année d'imposition »

"taxation year" of a non-resident entity that is not a corporation or an individual means a calendar year.

Tax avoidance motive

(1.1) Subject to subsection (1.3), a taxpayer has a tax avoidance motive in respect of a participating interest in a foreign investment entity if it is reasonable to conclude that the main reasons that the taxpayer acquired the participating interest include

(*a*) the derivation of a benefit all or substantially all of the value of which can reasonably be attributed, directly or indirectly, to income derived from investment property, to profits or gains from the

disposition of investment property, or to an increase in value of investment property; and

(*b*) the deferral or reduction of the amount of tax that would have been payable by the taxpayer under this Part had the taxpayer earned the income, or realized the profits or gains, from the investment property at the time the income was earned, or the profits or gains were realized, by the entities that owned or held the investment property.

Factors considered in tax avoidance motive

(1.2) Factors to be considered in determining the existence of a tax avoidance motive referred to in subsection (1.1) include

(*a*) the nature, organization and operation of the foreign investment entity and any other foreign investment entity in which it has a direct or indirect interest;

(*b*) the form of, and the terms and the conditions governing, the taxpayer's interest in or connection with the foreign investment entity;

(*c*) the direct or indirect interest of the taxpayer in any other foreign investment entity;

(*d*) the form of and the terms and the conditions governing the entity's direct or indirect interest in any other foreign investment entities;

(*e*) the extent to which the foreign investment entity and any other foreign investment entity in which the entity has a direct or indirect interest is subject to an income or profits tax on its income, profits and gains; and

(*f*) the extent to which the income, profits and gains of the foreign investment entity for a particular taxation year of the foreign investment entity are subject to an income or profits tax imposed on the interest holders in their taxation years that include the end of the particular taxation year or in their immediately following taxation years.

No tax avoidance motive

(1.3) A taxpayer does not have a tax avoidance motive in respect of a participating interest in a foreign investment entity held by the

taxpayer at a particular time if throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest

(*a*) the foreign investment entity, and each other foreign investment entity in which the foreign investment entity has a direct or indirect interest, allocate within 120 days of the end of each of their taxation years all or substantially all of their income, profits and gains for the year to the holders of participating interests in those entities in the year and the taxpayer includes the taxpayer's share of that income, profits and gains in computing the taxpayer's income for the taxation year of the taxpayer that includes the time at which the allocation is made; or

(*b*) the foreign investment entity was a "Regulated Investment Company" for the purposes of sections 851(b) and 852(a) of the United States *Internal Revenue Code* of 1986 and the taxpayer includes, in computing the taxpayer's income for a taxation year, the income allocated in that year to the taxpayer by the Regulated Investment Company.

Conditions for application of tax regime for foreign investment entities

(2) This subsection applies to a taxpayer for a particular taxation year of the taxpayer in respect of a participating interest in a non-resident entity if

(*a*) the taxpayer is not an exempt taxpayer;

(*b*) the participating interest is held by the taxpayer at the end of a taxation year of the non-resident entity that ends at or before the end of the particular taxation year;

(*c*) at the end of that taxation year of the non-resident entity it is a foreign investment entity; and

(*d*) at the end of that taxation year of the non-resident entity the taxpayer's participating interest is not an exempt interest.

Income inclusion and deduction

(3) Subject to subsection (4), where subsection (2) applies to a taxpayer resident in Canada for a particular taxation year of the taxpayer in respect of a participating interest or identical participating interests,

as the case may be, in a non-resident entity, in computing the income of the taxpayer for the particular year,

(*a*) there shall be added, as income from property, the positive amount, if any, determined by the formula

A - B - C - D

where

A is the taxpayer's income allocation in respect of the participating interest or the identical participating interests in the foreign investment entity for the entity's taxation year,

B is the taxpayer's loss allocation in respect of the participating interest or the identical participating interests in the foreign investment entity for the entity's taxation year,

C is the specified tax allocation of the taxpayer in respect of the participating interest or the identical participating interests in the foreign investment entity for the entity's taxation year, and

D is the amount, if any, by which

(i) the amount determined in respect of the taxpayer under subparagraph (*b*)(i) for the preceding taxation year of the entity in respect of the participating interest or the identical participating interests in the foreign investment entity or identical properties held by the taxpayer at the end of that preceding taxation year of the entity

exceeds

(ii) the amount determined in respect of the taxpayer under subparagraph (*b*)(ii) for the preceding taxation year of the entity in respect of the participating interest or the identical participating interests in the foreign investment entity held by the taxpayer at the end of that preceding taxation year of the entity; and

(*b*) there may be deducted, as a loss from property, the lesser of

(i) the absolute value of the negative amount, if any, determined by the formula in paragraph (*a*) in respect of the participating interest or the identical participating interests in the foreign investment entity for the entity's taxation year, and

(ii) the amount, if any, by which

(A) the total of all amounts each of which is an amount added under paragraph (*a*) in computing the taxpayer's income in respect of the participating interest or the identical participating interests in the foreign investment entity or identical properties held by the taxpayer at the end of a preceding taxation year of the entity

exceeds

(B) the total of all amounts each of which is an amount deductible under this paragraph in computing the taxpayer's income in respect of the participating interest or the identical participating interests in the foreign investment entity or identical properties held by the taxpayer at the end of a preceding taxation year of the entity.

Exceptions

(4) Subsection (3) applies to a taxpayer for a particular taxation year of the taxpayer, in respect of a participating interest or all the identical participating interests in a foreign investment entity, as the case may be, held by the taxpayer at the end of a taxation year of the entity that ends at or before the end of the particular taxation year, only if

(*a*) the taxpayer elects to have subsection (3) apply, in respect of the participating interest or all the identical participating interests in the foreign investment entity, as the case may be, in prescribed form and files the election with the Minister not later than the taxpayer's filing-due date for the particular year;

(*b*) the taxpayer has made a valid election referred to in paragraph (*a*), in respect of the participating interest or all the identical participating interests in the foreign investment entity, as the case may be, for each preceding taxation year of the taxpayer, that began after 2001, in which the taxpayer held the participating interest in the foreign investment entity or identical participating interests at the end of a taxation year of the entity that ended at or before the end of each of those taxation years of the taxpayer;

(*c*) subsection (17) does not apply to the taxpayer for the particular taxation year in respect of the participating interest or all the identical participating interests in the foreign investment entity, as the case may be;

(*d*) subsection 94.2(3) does not, because of subsection 94.2(9), apply to the taxpayer for the particular taxation year or a preceding taxation year in respect of the participating interest or all the identical

participating interests in the foreign investment entity, as the case may be;

(*e*) the taxpayer is not a foreign investment entity at the end of the particular taxation year;

(*f*) the participating interest or each of the identical participating interests in the foreign investment entity, as the case may be, is not a property that, under the terms or conditions in respect of it or any agreement relating to it, is convertible into, is exchangeable for or confers a right to acquire a participating interest in the foreign investment entity or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the foreign investment entity; and

(*g*) the participating interest or all the identical participating interests in the foreign investment entity, as the case may be, would, if this Act were read without reference to subparagraph 39(1)(*a*)(ii.3) and section 94.2, be capital property.

Income allocation

(5) In subsection (3), the income allocation of a particular taxpayer in respect of a participating interest or all the identical participating interests in a foreign investment entity, as the case may be, held by the taxpayer at the end of a particular taxation year of the entity is the amount determined by the formula

$$A \times \frac{B}{C}$$

where

A is the amount that would be the income of the entity for the particular taxation year of the entity if

(*a*) except for the purposes of section 91, paragraph (4)(*e*), subsection 107.4(1) and paragraph (*f*) of the definition "disposition" in subsection 248(1), the entity had been a taxpayer resident in Canada throughout the entity's existence,

(*b*) each property held by the entity at the beginning of a fresh-start year of the entity in respect of the particular taxpayer had been

(i) disposed of by the entity immediately before that time for proceeds equal to its fair market value at that time, and

(ii) reacquired by the entity at that time at a cost equal to that fair market value,

(*c*) for a fresh-start year of an entity in respect of the particular taxpayer and for each following taxation year of the entity, each deduction in computing the entity's income that is contingent on a claim by the entity had been claimed by the entity to the extent, and only to the extent, designated by the particular taxpayer in prescribed form filed with the Minister with the particular taxpayer's return of income for the particular taxpayer's taxation year in which that fresh-start year or the following year, as the case may be, ends,

(*d*) the entity had deducted the greatest amounts that it could have claimed or deducted as a reserve under sections 20, 138 and 140 for its taxation year that precedes a fresh-start year of the entity in respect of the particular taxpayer,

(*e*) in applying sections 37, 65 to 66.4 and 66.7, the entity had not existed before a fresh-start year of the entity in respect of the particular taxpayer,

(*f*) this Act were read without reference to subsections 20(11) and (12) and to subsections 104(4) to (6),

(*g*) dividends received by the entity in the particular taxation year of the entity from a foreign affiliate, of the particular taxpayer that is a corporation resident in Canada, were included in computing the income of the entity for the particular taxation year only if

(i) the particular taxpayer did not have a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) in the affiliate at the time the dividends were received, or

(ii) taking into account the application of paragraphs (*a*) and (*i*), subsection 94.2(4) applied for the purpose of computing the entity's income for the particular taxation year in respect of the entity's participating interest in the affiliate,

(*h*) where the entity holds at any time in the particular taxation year a participating interest in a non-resident entity, the description of D in paragraph 94.2(4)(*a*) did not apply in respect of that interest,

(*i*) the words "controlled foreign affiliate of the taxpayer" in paragraph (*a*) of the definition "exempt interest" referred to a controlled foreign affiliate of the particular taxpayer and not to a controlled foreign affiliate of the entity,

(*j*) the amount included in computing the entity's income for the particular taxation year in respect of capital gains were the amount, if any, by which the amount determined under subparagraph 3(*b*)(i) exceeds the amount determined under subparagraph 3(*b*)(ii) in respect of the entity for the particular taxation year of the entity,

(*k*) the amount deducted in computing the entity's income for the particular taxation year in respect of capital losses (other than business investment losses) were the amount, if any, by which the amount determined under subparagraph 3(*b*)(ii) exceeds the amount determined under subparagraph 3(*b*)(i) in respect of the entity for the particular taxation year of the entity, and

(*l*) the amount deducted in computing the entity's income for the particular taxation year in respect of business investment losses were the amount of its allowable business investment losses for the year;

B is the fair market value of those interests at the end of the particular taxation year of the entity; and

C is the fair market value of all participating interests in the entity at the end of the particular taxation year of the entity (other than a participating interest that is a property that, under the terms or conditions in respect of it or any agreement relating to it, is convertible into, is exchangeable for or confers a right to acquire a participating interest in the foreign investment entity or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the foreign investment entity).

Fresh-start year

(6) In subsection (5), a fresh-start year of a foreign investment entity in respect of a taxpayer is a taxation year of the entity

(*a*) that ends in a taxation year of the taxpayer that begins after 2001 if, at the end of the taxation year of the entity, the entity is a foreign investment entity and the taxpayer holds a participating interest, other than an exempt interest, in the entity; and

(*b*) that begins immediately after a preceding taxation year of the entity at the end of which the entity was not a foreign investment entity or the taxpayer did not hold a participating interest in the entity.

Loss allocation

(7) In subsection (3), the loss allocation of a particular taxpayer in respect of a participating interest or all the identical participating interests in a foreign investment entity, as the case may be, held by the taxpayer at the end of a particular taxation year of the entity is the amount determined by the formula

$$(A - B) \times \frac{C}{D}$$

where

A is the total of all amounts each of which would, if paragraphs (*a*) to (*i*) of the description of A in subsection (5) applied, be

(*a*) a loss of the entity for the particular taxation year of the entity from business or property,

(*b*) the amount, if any, by which the amount determined under subparagraph 3(*b*)(ii) exceeds the amount determined under subparagraph 3(*b*)(i) in respect of the entity for the particular taxation year of the entity, or

(*c*) an allowable business investment loss of the entity for the particular taxation year of the entity;

B is the amount that would, if paragraphs (*a*) to (*i*) of the description of A in subsection (5) applied, be determined under paragraph 3(*c*) in respect of the entity for the particular taxation year of the entity;

C is the fair market value of those interests at the end of the particular taxation year of the entity; and

D is the fair market value of all participating interests in the entity at the end of the particular taxation year of the entity (other than a participating interest that is a property that, under the terms or conditions in respect of it or any agreement relating to it, is convertible into, is exchangeable for or confers a right to acquire a participating interest in the foreign investment entity or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the foreign investment entity).

Specified tax allocation

(8) In subsection (3), the specified tax allocation of a taxpayer in respect of a participating interest or all the identical participating interests in a foreign investment entity, as the case may be, held by the taxpayer at the end of a particular taxation year of the entity is the total of all amounts each of which is the amount determined, in respect of the particular taxation year of the entity, by the formula

$$A \times (B/C) \times D$$

where

A is

(*a*) if the particular taxation year of the entity ends in a taxation year of the taxpayer that begins after 2001, the income or profits tax paid in respect of the particular taxation year of the entity by the entity, and

(*b*) in any other case, nil;

B is the total fair market value of the participating interest or the identical participating interests in the entity (other than rights to acquire shares of the capital stock of, or interests in, the entity) held by the taxpayer at the end of the particular taxation year of the entity;

C is the fair market value of all participating interests in the entity at the end of the particular taxation year (other than a participating interest that is property that, under the terms or conditions in respect of it or any agreement relating to it, is convertible into, is exchangeable for or confers a right to acquire a participating interest in the foreign investment entity or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the foreign investment entity); and

D is the taxpayer's relevant tax factor, within the meaning assigned by subsection 95(1), for the taxation year of the taxpayer in which the particular taxation year of the entity ends.

Adjusted cost base

(9) In computing the adjusted cost base to a taxpayer of a participating interest in an entity at and after the end of a taxation year of the entity

(*a*) there shall be added the total of,

(i) that portion of the amount added under paragraph (3)(*a*) in computing the taxpayer's income that is attributable to the interest for the entity's taxation year (or that would have been so added if this Act were read without reference to subsection 56(4.1) and sections 74.1 to 75), and

(ii) the product obtained when the amount determined under paragraph (*j*) of the description of A in subsection (5) for the entity's taxation year is multiplied by the amount determined by the fraction B/C described in the formula in subsection (5) that was used in computing the taxpayer's income allocation in respect of the interest in the entity held by the taxpayer at the end of the entity's taxation year; and

(*b*) there shall be deducted the total of

(i) that portion of the amount deducted under paragraph (3)(*b*) in computing the taxpayer's income that is attributable to the interest for the entity's taxation year (or that would have been so deducted if this Act were read without reference to subsection 56(4.1) and sections 74.1 to 75),

(ii) the product obtained when the amount determined under paragraph (*j*) of the description of A in subsection (5) for the entity's taxation year is multiplied by the amount determined by the fraction C/D described in the formula in subsection (7) that was used in computing the taxpayer's loss allocation in respect of the interest in the entity held by the taxpayer at the end of the entity's taxation year, and

(iii) the product obtained when the amount determined under paragraph (*l*) of the description of A in subsection (5) for the entity's taxation year is multiplied by the amount determined by the fraction C/D described in the formula in subsection (7) that was used in computing the taxpayer's loss allocation in respect of the interest in the entity held by the taxpayer at the end of the entity's taxation year.

Property deemed owned by an entity

(10) In determining whether a particular entity that has a significant interest in a corporation, a partnership or a non-discretionary trust, (in this subsection referred to as the "investee") is a foreign investment entity at any time

(*a*) the carrying value of each participating interest held at that time by the particular entity in the investee and of each debt owing to the

particular entity by the investee (other than a debt acquired in the ordinary course of a business that is not an investment business carried on by the particular entity) is deemed to be nil;

(*b*) the property owned at that time by the investee is deemed to be owned at that time by the particular entity and is deemed to have a carrying value at that time equal to the amount determined by the formula

A x B/C

where

A is

(i) if the taxpayer has made a valid election under paragraph (*b*) of the definition "carrying value" in subsection (1) to value the property of the particular entity at its fair market value at that time, the fair market value of the property of the investee at that time, or

(ii) in any other case, the amount that would be the carrying value of the property to the investee at that time if that definition were read without reference to paragraph (*b*),

B is the total of all amounts each of which is

(i) the fair market value at that time of a participating interest in the investee owned at that time by the particular entity, and

(ii) the fair market value at that time of a debt (other than a debt acquired in the ordinary course of a business that is not an investment business carried on by the particular entity) that the investee owes at that time to the particular entity, and

C is the total of all amounts each of which is

(i) the fair market value at that time of a participating interest in the investee owned at that time by an individual or an entity other than the particular entity, and

(ii) the fair market value at that time of a debt owing at that time by the investee to a holder of a participating interest in the investee (other than a debt acquired in the ordinary course of a business that is not an investment business carried on by a holder of a participating interest in the investee); and

(*c*) the particular entity is deemed to have carried on at that time the activities carried on at that time by the investee in which it used the property referred to in paragraph (*b*) to the extent that the particular entity's interest at that time in the carrying value of the property of the investee as determined under paragraph (*b*) is of the total carrying value at that time of the property of the investee as determined under paragraph (*b*).

Significant interest in an entity

(11) In this section and section 94.2, an entity has a significant interest

(*a*) in a corporation at any time if at that time the entity or the entity together with entities related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) holds shares of the capital stock of the corporation

(i) that would give the entity, or the entity together with entities related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)), 25% or more of the votes that could be cast under all circumstances at an annual meeting of shareholders of the corporation, and

(ii) that have a fair market value of 25% or more of the fair market value of all of the issued and outstanding shares of the corporation;

(*b*) in a partnership at any time if at that time the entity, or the entity together with entities related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)), holds interests in the partnership that have a fair market value of 25% or more of the fair market value of all interests in the partnership; and

(*c*) in a non-discretionary trust at any time if at that time the entity, or the entity together with entities related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)), holds interests in the trust that have a fair market value of 25% or more of the fair market value of all interests in the trust.

Entity treated as controlled foreign affiliate

(12) Subject to subsection (17), a non-resident entity is deemed to be a controlled foreign affiliate of a taxpayer throughout the period that begins at the earliest time in a particular taxation year of the taxpayer

at which the non-resident entity is a foreign affiliate of the taxpayer and ends at the earliest subsequent time at which its not a foreign affiliate of the taxpayer, if

(*a*) at any time in the particular taxation year of the taxpayer, the taxpayer, or a controlled foreign affiliate of the taxpayer, holds a participating interest in a non-resident entity;

(*b*) a taxation year of the non-resident entity ends at or before the end of the particular taxation year of the taxpayer;

(*c*) the non-resident entity is, at the end of the particular taxation year of the taxpayer, a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest within the meaning assigned by paragraph 95(2)(*m*);

(*d*) the taxpayer elects in prescribed form in the taxpayer's return of income for the particular taxation year to treat the non-resident entity as a controlled foreign affiliate of the taxpayer; and

(*e*) the taxpayer has not made an election that would, if this Act were read without reference to subsection (17), be an election referred to in paragraph (*d*) in respect of the non-resident entity for any taxation year of the taxpayer that precedes the particular taxation year.

Special rules – re determining foreign investment entity status

(13) In determining whether an entity is at a particular time a foreign investment entity, a particular property held by the entity at the particular time is deemed not to be an investment property if

(*a*) the particular property (or other property for which the particular property is substituted property) was acquired at any time within the 36-month period ending at the particular time (or within any longer period ending at the particular time that the Minister considers reasonable if the entity applies, in writing, to the Minister within 36 months after the property was acquired by the entity) because the entity

(i) issued a debt or a participating interest in the entity,

(ii) disposed of property used principally in a business, other than an investment business, carried on by the entity or an entity related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)),

(iii) disposed of a participating interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business, other than an investment business, carried on by the other entity or an entity related to the other entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)), or

(iv) accumulated income of the entity derived from a business, other than an investment business, carried on by the entity or an entity related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)); and

(*b*) the issuance, disposition or accumulation referred to in paragraph (*a*) was made or amassed for purpose of

(i) acquiring property to be used principally in, or making expenditures for the purpose of earning income from, a business, other than an investment business, carried on by the entity or an entity related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)), or

(ii) acquiring a participating interest that is a significant interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business, other than an investment business, carried on by the other entity.

Special rules – re determining qualifying entity status

(14) In determining whether an entity is at a particular time a qualifying entity, a particular property held by the entity at the particular time is deemed not to be an investment property if

(*a*) the particular property (or other property for which the particular property is substituted property) was acquired at any time within the 36-month period ending at the particular time (or within any longer period ending at the particular time that the Minister considers reasonable if the entity applies, in writing, to the Minister within 36 months after the property was acquired by the entity) because the entity

(i) issued a debt or a participating interest in the entity,

(ii) disposed of property described in any of paragraphs (*a*) to (*d*) of the definition "qualifying entity" in subsection (1), or

(iii) accumulated income of the entity; and

(*b*) the issuance, disposition or accumulation referred to in paragraph (*a*) was made or amassed for purpose of acquiring property that, if owned by the entity, would be property described in paragraph (*a*) to (*d*) of the definition "qualifying entity" in subsection (1).

Determination of foreign investment entity and exempt interest status

(15) In determining whether a non-resident entity is a foreign investment entity, or whether a participating interest in a foreign investment entity held by a taxpayer is an exempt interest, at a particular time,

(*a*) if a balance sheet and statement of income of the non-resident entity prepared for a period that ends at the particular time in accordance with generally accepted accounting principles used in Canada at that time have not been made available to holders of participating interests in the non-resident entity, then a balance sheet and statement of income of the non-resident entity prepared for that period that have been made available to holders of participating interests in the non-resident entity and that are in accordance with generally accepted accounting principles used at that time in the United States of America or in countries that are members of the European Union are considered to have been prepared in accordance with generally accepted accounting principles that are substantially similar to those used in Canada at that time;

(*b*) if the non-resident entity is resident in a country in which there is a prescribed stock exchange, participating interests in the non-resident entity are listed on a prescribed stock exchange, and the unconsolidated balance sheet and statement of income of the non-resident entity prepared for a period that ends at the particular time have not been made available to holders of participating interests in the non-resident entity, then a consolidated balance sheet and statement of income of the non-resident entity prepared for that period that have been made available to holders of participating interests in the non-resident entity and that are in accordance with generally accepted accounting principles used in Canada at that time or in accordance with generally accepted accounting principles that are substantially similar to those used in Canada at that time are considered to be the balance sheet and income statement of the entity for that period;

(*c*) if the consolidated statements of an entity referred to in paragraph (*b*) are used to determine whether the entity is a foreign investment entity or whether a participating interest in the entity is an exempt interest, then the business and non-business activities of each other entity the assets, liabilities and income or loss of which are reflected in the consolidated financial statements of the entity that are prepared for a period ending at the particular time are considered to have been carried on by the entity to the same extent as the entity's proportional interest in the retained earnings and income of those other entities;

(*d*) if there are at the particular time participating interests that may at or after the particular time be exchanged for or converted into participating interests in a non-resident entity, all of those exchangeable or convertible participating interests are deemed to have been immediately before the particular time exchanged for or converted into the number and types of participating interests in the other entity for which the exchangeable or convertible participating interests of the entity are exchangeable for or convertible into and are, except in applying this paragraph, deemed not to exist at the particular time;

(*e*) in determining whether the principal business of an entity is an investment business at the end of a taxation year of the entity,

(i) the principal business of the entity is deemed to be an investment business if the total net accounting income of the entity for the year derived from investment property (other than investment property used or held in the course of carrying on an investment business) and from investment businesses is greater than the total net accounting income of the entity for the year derived from businesses other than investment businesses,

(ii) the principal business of the entity is deemed not to be an investment business if the total net accounting income of the entity for the year derived from investment property (other than investment property used or held in the course of carrying on an investment business) and from investment businesses is less than the total net accounting income of the entity for the year derived from businesses (other than investment businesses) carried on by the entity in the year, and

(iii) in any other case, the principal business of the entity is to be determined by reference to the facts and circumstances including the carrying value of assets used in the activities carried on in the year by the entity, the amount of time spent by the entity's employees in carrying out those activities, the amount of expenditures incurred by the entity in respect of those activities

and the net accounting income derived by the entity from those activities;

(*f*) the net accounting income of an entity for a taxation year of the entity is the amount that would be its net income for the year, before income taxes and extraordinary items, in its financial statements for the year if those financial statements were prepared in accordance with generally accepted accounting principles used in Canada at the end of the year or in accordance with generally accepted accounting principles substantially similar to generally accepted accounting principals used in Canada at the end of the year;

(*g*) participating interests in a foreign investment entity are deemed to be widely held at the particular time if, at that time

(i) at least 150 persons who deal at arm's length with each other and the foreign investment entity own interests in the foreign investment entity that are identical to the participating interests, and

(ii) each of those persons owns interests the total value of which is at least $500; and

(*h*) participating interests in a foreign investment entity are considered to be actively traded at the particular time if, at that time

(i) the participating interests are listed on a prescribed exchange or are qualified for distribution to the public under the securities law of the country or of a political subdivision of the country under the laws of which the foreign investment entity was formed, organized or continued under or exists and is governed, and

(ii) the participating interests can be purchased and sold by any member of the public in the open market or can be purchased from and sold to the entity by any member of the public.

Demand for information

(16) Subsection (17) applies to a taxpayer for a taxation year of the taxpayer if

(*a*) the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to make a determination of an amount that would, if this Act were read without reference to subsection (17), be required to be added or deducted (otherwise than under subsection 104(13)) in computing the taxpayer's income for the year because of the application of

(i) section 91 and an election under paragraph (12)(*d*) in respect of a foreign affiliate, or

(ii) subsection (3) and an election under paragraph (4)(*a*) in respect of a participating interest in an entity; and

(*b*) sufficient information to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand.

Effect of insufficient information

(17) In computing the taxpayer's income for the particular taxation year referred to in subsection (16) and all following taxation years,

(*a*) if the demand referred to in paragraph (16)(*a*) is in respect of the computation of the taxpayer's income for the particular taxation year having regard to the application of section 91 and an election under paragraph (12)(*d*),

(i) that election is deemed never to have been made, and

(ii) subsection (3) does not apply in respect of the foreign affiliate that was the subject of the election; and

(*b*) if the demand referred to in paragraph (16)(*a*) is in respect of the computation of the taxpayer's income for the particular taxation year having regard to the application of subsection (3) and an election under paragraph (4)(*a*) in respect of a participating interest in an entity,

(i) that election is deemed never to have been made, and

(ii) subsection (3) does not apply in respect of the participating interest that was the subject of the election.

Foreign Investment Entities – Mark-to-market

Definitions

94.2 (1) In this section,

(*a*) the definitions in subsection 94.1(1) apply;

(*b*) subject to subsections (6) and (13) to (17), "deferral amount" of a taxpayer in respect of a participating interest in an entity means the positive or negative amount determined by the formula

A x (B - C)

where

A is

(i) if, immediately before the beginning of the taxpayer's first taxation year that began after 2001, the interest was capital property held by the taxpayer, 1/2, and

(ii) in any other case, 1,

B is

(i) the fair market value of the interest at the first time in a particular taxation year of the taxpayer at which the taxpayer was resident in Canada where

(A) the taxpayer held the interest at the end of the preceding taxation year,

(B) at the end of that preceding year, the taxpayer was resident in Canada or the interest was taxable Canadian property,

(C) subsection (4) did not apply to the taxpayer for the purpose of computing the taxpayer's income in respect of the interest for any preceding taxation year, and

(D) subsection (4) applies to the taxpayer for the purpose of computing the taxpayer's income in respect of the interest for the particular year, and

(ii) nil in any other case, and

C is

(i) if subparagraph (i) of the description of B applies in respect of the interest, the cost amount of the property immediately before the first time in the particular year at which the taxpayer was resident in Canada, and

(ii) nil in any other case; and

(*c*) "gross-up factor" for a deferral amount is

(i) if the amount determined for A in respect of the deferral amount is 1/2, 2, and

(ii) in any other case, 1.

Rules of application

(2) For the purposes of this section

(*a*) identical participating interests held by a taxpayer are deemed to be disposed of in the order in which they were acquired by the taxpayer, determined without reference to any other provision of this Act; and

(*b*) subsections 94.1(10), (11) and (13) to (15) apply.

Where mark-to-market method applies

(3) Subject to paragraph (5)(*b*), this subsection applies to a taxpayer throughout a taxation year in respect of a participating interest held in the year by the taxpayer in a non-resident entity where

(*a*) subsection (9) or (10) applies to the taxpayer for the year in respect of the interest; or

(*b*) both

(i) subsection 94.1(2) applies to the taxpayer for the year in respect of the interest, and

(ii) because of subsection 94.1(4), subsection 94.1(3) does not apply to the taxpayer for the year in respect of the interest.

Mark-to-market

(4) Where subsection (3) applies to a taxpayer throughout a taxation year in respect of a participating interest in a non-resident entity, subject to subsection (19),in computing the taxpayer's income for the year in respect of the interest

(*a*) there shall be added, as income from property, the positive amount, if any, determined by the formula

$$(A + B + C + D) - (E + F + G)$$

where

A is the total of all amounts each of which is the taxpayer's proceeds from a disposition of the interest in the year (other than a

disposition deemed to arise because of subsection 128.1(4) or 149(10)),

B is

(i) if the taxpayer held the interest at the end of the year, the fair market value at that time of the interest (determined before taking into account any amount payable at the end of the year from the entity in respect of the interest), and

(ii) in any other case, nil,

C is the total of all amounts (other than an amount to which the description of A applies) received by the taxpayer in the year from the entity in respect of the interest,

D is

(i) the taxpayer's deferral amount in respect of the interest, if

(A) the deferral amount is a positive amount,

(B) the interest was not disposed of by the taxpayer in the year, and

(C) the taxpayer so elects in respect of the interest in prescribed form filed with the Minister not later than the taxpayer's filing-due date for the year,

(ii) the taxpayer's deferral amount in respect of the interest if

(A) the taxpayer disposed of the interest in the year, and

(B) no election was made under subparagraph (i) in respect of the interest by the taxpayer for a preceding taxation year, and

(iii) in any other case, nil,

E is the total of all amounts each of which is the cost at which the taxpayer acquired the interest in the year (otherwise than because of an acquisition deemed to arise because of subsection 128.1(4) or 149(10)),

F is

(i) if the taxpayer held the interest at the beginning of the year, the fair market value at that time of the interest (determined

before taking into account any amount payable at that time from the entity in respect of the interest), and

(ii) in any other case, nil, and

G is

(i) if the interest was deemed by paragraph (10)(*a*) to be a participating interest in an entity for the preceding taxation year of the taxpayer, the amount that would be deductible under paragraph (*b*) in computing the taxpayer's income for that preceding taxation year in respect of the interest if this subsection were read without reference to subparagraph (*b*)(i), and

(ii) in any other case, nil; and

(*b*) there may be deducted, as a loss from property,

(i) if the interest was deemed by paragraph (10)(*a*) to be a participating interest in an entity for the year, nil, and

(ii) in any other case, the absolute value of the negative amount, if any, determined by the formula in paragraph (*a*).

Non-resident periods excluded

(5) Where a taxpayer is non-resident at any time in a taxation year

(*a*) for the purpose of subsection (4) (other than the description of D in paragraph (4)(*a*)), the year is deemed to be the period, if any, that begins at the first time in the year at which the taxpayer is resident in Canada and ends at the last time in the year at which the taxpayer is resident in Canada;

(*b*) except for the purposes of subsection (4) and paragraph (*c*), subsection (3) does not apply to the taxpayer at that time; and

(*c*) if the taxpayer is an individual who was non-resident throughout a particular period that is within the period described in paragraph (*a*), at any time in the particular period, the individual holds a participating interest in a non-resident entity and subsection (3) applies to the individual throughout the particular period in respect of the interest,

(i) for the purpose of section 114, the income or loss of the individual in respect of the interest for the particular period shall be determined without reference to this section, and

(ii) in computing the amount determined under paragraph 114(*a*) in respect of the individual for the year

(A) there shall be deducted any amount that would be included under paragraph (4)(*a*) in computing the individual's income in respect of the interest for the particular period if

(I) the value of D in paragraph (4)(*a*) were nil, and

(II) the particular period were a taxation year, and

(B) there shall be added any amount that would be deductible under paragraph (4)(*b*) in computing the individual's income in respect of the interest for the particular period if

(I) the value of D in paragraph (4)(*a*) were nil, and

(II) the particular period were a taxation year.

Foreign partnership – member becoming resident

(6) If, at a particular time in a fiscal period of a partnership, a person resident in Canada becomes a member of the partnership, or a person who is a member of the partnership becomes resident in Canada and immediately before the particular time no member of the partnership is resident in Canada,

(*a*) all amounts determined under this section shall be determined as if that period began at the first time in that period at which a member of the partnership was resident in Canada;

(*b*) for the purpose of the definition "deferral amount" in paragraph (1)(*b*), as it applies in respect of dispositions that occur after the particular time and before the first subsequent time to which this subsection applies in respect of the partnership, subsection (4) is deemed not to have applied to the partnership for any preceding fiscal period; and

(*c*) where a negative deferral amount would, if this Act were read without reference to this paragraph, be determined in respect of a participating interest held by the partnership immediately before the

particular time, the deferral amount in respect of the interest is deemed to be nil.

Foreign partnership – members ceasing to be resident

(7) If, at a particular time in a fiscal period of a partnership, a person resident in Canada ceases to be a member of the partnership, or a person who is a member of the partnership ceases to be resident in Canada and immediately after the particular time no member of the partnership is resident in Canada, all amounts determined under this section shall be determined as if that period ended at the last time in that period at which a member of the partnership was resident in Canada.

Application of subsections (6) and (7)

(8) In subsections (6) and (7) and this subsection,

(*a*) if it can reasonably be considered that one of the main reasons that a member of a partnership is resident in Canada is to avoid the application of subsection (6) or (7), the member is deemed not to be resident in Canada; and

(*b*) if a particular partnership is a member of another partnership at any time,

(i) each person or partnership that is at that time a member of the particular partnership is deemed to be a member of the other partnership at that time,

(ii) each person or partnership that becomes at that time a member of the particular partnership is deemed to become a member of the other partnership at that time, and

(iii) each person or partnership that ceases at that time to be a member of the particular partnership is deemed to cease to be a member of the other partnership at that time.

Tracked interests

(9) Subject to paragraph (5)(*b*), subsection (3) applies to a taxpayer throughout a particular taxation year of the taxpayer in respect of a participating interest in a non-resident entity if

(*a*) the taxpayer holds the interest at any time in the particular taxation year;

(*b*) a taxation year of the entity ends at or before the end of the particular taxation year;

(*c*) the taxpayer is not an exempt taxpayer for the particular taxation year;

(*d*) the participating interest is not a mark-to-market property (within the meaning assigned by subsection 142.2(1)) held by a financial institution (within the meaning assigned by that subsection);

(*e*) the entitlement to receive payments from the entity, whether directly or indirectly in any manner whatever, in respect of the interest (or its fair market value) is determined, either directly or indirectly, primarily by reference to production, revenue, profit or cash flow from, the fair market value or the use of, or any similar criterion in respect of, a property or group of properties (each of which is referred to in paragraphs (*f*), (*g*) and (*h*) as a "tracked property");

(*f*) at the end of the latest of the entity's taxation years described in paragraph (*b*), all or substantially all of the fair market value of the tracked properties cannot be attributed, either directly or indirectly, to the fair market value of properties that are shares of the capital stock of a particular foreign affiliate of the taxpayer that,

(i) if held by the taxpayer, would be a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) of the taxpayer in the particular foreign affiliate of the taxpayer,

(ii) if held by the taxpayer, would be a participating interest in a qualifying entity, and

(iii) are not tracked properties in respect of a participating interest in a non-resident entity held by another taxpayer or entity that is not related to the taxpayer;

(*g*) at the end of the latest of the entity's taxation years described in paragraph (*b*), the tracked properties

(i) do not include all of the properties that would be owned by the entity if this Act were read without reference to subsection 94.1(10), or

(ii) include a property that would not be owned by the entity if this Act were read without reference to subsection 94.1(10) but do

not include all of the property that is owned by the entity when this Act is read with reference to subsection 94.1(10); and

(*h*) either

(i) at the end of the latest of the entity's taxation years described in paragraph (*b*), the total of all amounts each of which is

(A) the carrying value of an investment property that is a tracked property owned at the end of that year by the entity, or

(B) an amount that would, if this Act were read without reference to paragraph 94.1(10)(*a*), be the carrying value of a tracked property that is

(I) owned at the end of the year by the entity,

(II) deemed by paragraph 94.1(10)(*a*) to have a carrying value of nil, and

(III) either a participating interest in a foreign investment entity or indebtedness owing by a foreign investment entity,

exceeds one-half of the total of all amounts each of which is the entity's carrying value (determined without reference to paragraph 94.1(10)(*a*)) of a tracked property owned by it at the end of that year, or

(ii) at the end of the latest of the entity's taxation years described in paragraph (*b*)

(A) the entity, or another non-resident entity, owns an investment property (other than a tracked property owned by the entity), and

(B) it is reasonable to conclude that the production, revenue, profit or cash flow from the investment property, the increase in the fair market value of the investment property, or any other return on the investment property based on a similar criterion, is intended to enable the entity to satisfy all or part of an entitlement referred to in paragraph (*e*).

Treatment of foreign insurance policies

(10) If, in a particular taxation year of a taxpayer resident in Canada (other than an exempt taxpayer), the taxpayer holds an interest in an insurance policy (other than an insurance policy issued by an insurer in

the course of carrying on an insurance business in Canada, the income from which is subject to tax under this Part),

(*a*) in applying subsections (3) and (4) and paragraph (*d*.1) of the definition "specified foreign property" in subsection 233.3(1) to the taxpayer in respect of the interest for the particular year,

(i) the interest is deemed at each time in the particular year that it is held by the taxpayer to be a participating interest in a non-resident entity,

(ii) subsection (3) is deemed to apply to the taxpayer throughout the particular year in respect of the interest, and

(iii) the value of D in paragraph (4)(*a*) is deemed to be nil;

(*b*) section 12.2, paragraphs 56(1)(*d*) and (*j*) and 60(*a*) and (*s*) and sections 138.1 and 148 do not apply in respect of the interest for the purpose of computing the taxpayer's income for the year;

(*c*) paragraphs (*a*) and (*b*) do not apply to a taxpayer for a taxation year in respect of an insurance policy if

(i) the taxpayer is an individual and the interest in the policy was acquired by the individual more than 60 months before the individual became resident in Canada unless, after the day that is 60 months before the day that the individual became resident in Canada, the individual paid premiums in respect of the policy that are in excess of the level that can reasonably be considered to have been contemplated at the time the first interest in the policy was acquired,

(ii) under the terms and conditions of the insurance policy, the taxpayer is entitled to receive only benefits payable as a consequence of the occurrence of risks insured under the policy or a return of premiums previously paid upon the surrender, cancellation or termination of the insurance policy, or

(iii) the taxpayer can establish to the satisfaction of the Minister that the taxpayer has included in computing the taxpayer's income for the particular year the amount required under section 12.2 to be included in computing the taxpayer's income for that year in respect of the interest;

(*d*) for the purpose of subsection (4), an interest in an insurance policy held by a taxpayer at the end of a particular taxation year is deemed to have been acquired by the taxpayer at the beginning of the

following taxation year at a cost equal to the fair market value at the end of the particular taxation year of the interest if

(i) paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular year, and

(ii) paragraphs (*a*) and (*b*) apply to the taxpayer in respect of the interest for the taxpayer's following taxation year;

(*e*) for the purpose of subsection (4), an interest in an insurance policy held by a taxpayer at the beginning of a particular taxation year is deemed to have been disposed of by the taxpayer at end of the taxpayer's preceding taxation year for proceeds of disposition equal to its fair market value at the end of that preceding taxation year if

(i) paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular taxation year, and

(ii) paragraphs (*a*) and (*b*) applied to the taxpayer in respect of the interest for the taxpayer's preceding taxation year;

(*f*) in this subsection and subsection (4), the fair market value of an interest in an insurance policy, the proceeds of disposition of an interest in an insurance policy and amounts paid to a beneficiary in respect of an interest in an insurance policy are each determined without reference to benefits paid, payable or anticipated to be payable, under the insurance policy as a consequence only of the occurrence of the risks insured under the insurance policy,

(*g*) for the purposes of this subsection and subsection (4),

(i) an interest in an insurance policy is deemed to have been acquired by the taxpayer in a particular year (notwithstanding that the interest was held by the taxpayer at the end of the preceding taxation year), where the taxpayer made a payment described in subparagraph (ii) in respect of a premium or a loan under the policy in the particular year,

(ii) the cost to the taxpayer of an interest in an insurance policy acquired in a particular year is the total of all amounts each of which is

(A) the amount of a premium paid by the taxpayer in the particular year under the insurance policy to the extent that it cannot be refunded (otherwise than on termination or cancellation of the policy) and is not a payment in respect of a benefit described in subparagraphs (*c*)(i) to (vii) of the definition "premium" in subsection 148(9), and

(B) the amount of a payment made by the taxpayer in the particular year in respect of the principal amount of a loan made under the insurance policy in any year to the extent that the loan was included in determining the value of C in the formula in subsection (4) for the taxation year in which the loan was made;

(*h*) if, under paragraph (*d*), a taxpayer is deemed to have acquired an interest in an insurance policy at the beginning of a taxation year (in this paragraph referred to as the "acquisition year"), the taxpayer may add to the cost of that interest, the amount, if any, by which

(i) the total amount of premiums paid by the taxpayer before the beginning of the acquisition year in respect of that interest at a time at which the taxpayer was resident in Canada and not an exempt taxpayer for the year in respect of the interest (to the extent that the premiums paid cannot be refunded otherwise than on termination or cancellation of the policy and are not premiums paid in respect of a benefit described in subparagraphs (*c*)(*i*) to (*vii*) of the definition "premium" in subsection 148(9))

exceeds

(ii) the total of the fair market value, at the beginning of the acquisition year, of that interest and the total of the amounts received by the taxpayer before the beginning of the acquisition year under the policy at a time at which the taxpayer was resident in Canada and not an exempt taxpayer for the year in respect of the interest;

(*i*) in subsection (4), if the amount determined under subparagraph (*h*)(ii) exceeds the amount determined under subparagraph (*h*)(i) in respect of an interest in an insurance policy of a taxpayer described in paragraph (*h*), the amount of the excess shall be added in computing the taxpayer's proceeds of disposition of that interest for the taxation year in which the taxpayer disposes of the interest otherwise than because of paragraph (*e*); and

(*j*) where an interest in an insurance policy is held by a taxpayer at the beginning of a particular taxation year, paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular taxation year and paragraphs (*a*) and (*b*) applied to the taxpayer in respect of the interest for the taxpayer's preceding taxation year, the interest is deemed to have been acquired by the taxpayer at the beginning of the particular taxation year at a cost equal to the amount, if any, by which

(i) the total of the fair market value, at the end of the taxpayer's preceding taxation year, of the interest and the amount that would be determined under paragraph (4)(*b*) in respect of the interest in respect of the taxpayer for the taxpayer's preceding taxation year if this Act were read without reference to subparagraph (4)(*b*)(i),

exceeds

(ii) the amount determined under paragraph (*i*) in respect of the interest in respect of the taxpayer.

Change of status of entity

(11) If a participating interest in a non-resident entity is held by a taxpayer at the beginning of a taxation year, subsection (4) applied for the purpose of computing the taxpayer's income in respect of the interest for the preceding taxation year and that subsection does not apply for the purpose of computing the taxpayer's income in respect of the interest for the taxation year (otherwise than because the taxpayer became an exempt taxpayer or ceased to reside in Canada),

(*a*) subject to paragraph (*c*), the taxpayer is deemed to have acquired the interest at the beginning of the year at a cost equal to its fair market value at that time;

(*b*) if the interest is capital property at the beginning of the year, in computing the adjusted cost base after that time to the taxpayer of the interest

(i) except where the taxpayer has made an election in respect of the interest under clause (i)(C) of the description of D in paragraph (4)(*a*), there shall be deducted the product of any positive deferral amount in respect of the interest and the gross-up factor for the deferral amount, and

(ii) there shall be added the product of the absolute value of any negative deferral amount in respect of the interest and the gross-up factor for the deferral amount; and

(*c*) where paragraph (*b*) does not apply,

(i) except where the taxpayer has made an election in respect of the interest under clause (i)(C) of the description of D in paragraph (4)(*a*), there shall be deducted in computing the cost to the taxpayer of the interest the lesser of

(A) the product of any positive deferral amount in respect of the interest and the gross-up factor for the deferral amount, and

(B) the cost to the taxpayer of the interest, determined without reference to this subparagraph,

(ii) there shall be included in computing the taxpayer's income for the year in respect of the interest the amount, if any, by which

(A) the amount determined under clause (i)(A) in respect of the interest

exceeds

(B) the amount determined under clause (i)(B) in respect of the interest, and

(iii) there shall be added in computing the cost to the taxpayer of the interest the product of the absolute value of any negative deferral amount in respect of the interest and the gross-up factor for the deferral amount.

Cost of participating interest

(12) If a taxpayer's participating interest in a non-resident entity is disposed of by the taxpayer at a particular time in a taxation year and subsection (4) applies for the purpose of computing the taxpayer's income for the year in respect of the interest, in determining the taxpayer's cost of the interest immediately before the particular time

(*a*) if the interest was held by the taxpayer at the beginning of the year, its cost to the taxpayer immediately before the particular time is deemed to be equal to the fair market value at the beginning of the year of the interest; and

(*b*) in any other case, its cost to the taxpayer immediately before the particular time is deemed to be equal to the amount that would be its cost to the taxpayer at the particular time if this Act were read without reference to this section (other than subsection (2)).

Deferral amount where same interest reacquired

(13) Subject to subsections (14) to (17), if a taxpayer disposes of a participating interest in an entity at any time in a taxation year of the taxpayer and subsection (4) applies for the purpose of computing the

taxpayer's income for the year in respect of the interest, in applying subsection (4) to dispositions after that time the deferral amount of the taxpayer in respect of the interest is nil.

Fresh-start re change of status of entity

(14) If a participating interest is deemed by paragraph (11)(*a*) to have been acquired at a particular time by a taxpayer, for the purpose of applying subsection (4) to a subsequent disposition of the interest and a subsequent election in respect of the interest under clause (i)(C) of the description of D in paragraph (4)(*a*), the deferral amount of the taxpayer in respect of the interest shall

(*a*) for the purpose of clause (i)(C) of the description of B in the definition "deferral amount" in paragraph (1)(*b*), be determined as if subsection (4) had not applied to the taxpayer in respect of the interest for taxation years that began before the particular time; and

(*b*) be determined without reference to the application of subsection (13) with regard to dispositions that occurred before the particular time.

Fresh-start after emigration of taxpayer

(15) If a taxpayer ceases at a particular time to be resident in Canada, for the purpose of applying subsection (4) to dispositions, and elections under clause (i)(C) of the description of D in paragraph (4)(*a*), that occur or that are made after the particular time, the deferral amount in respect of the taxpayer's participating interests shall

(*a*) for the purpose of clause (i)(C) of the description of B in the definition "deferral amount" in paragraph (1)(*b*), be determined as if subsection (4) had not applied to the taxpayer in respect of participating interests for taxation years that began before the particular time; and

(*b*) be determined without reference to the application of subsection (13) with regard to dispositions that occurred before the particular time.

Fresh-start re change of status of tax-exempt entity

(16) If, a taxpayer was not an exempt taxpayer for a particular taxation year, and the taxpayer is an exempt taxpayer for the following taxation year because of the application of paragraph (*b*) of the definition "exempt taxpayer" in subsection 94.1(1), in applying subsection (4) to dispositions, and elections under clause (i)(C) of the description of D in paragraph (4)(*a*), that occur or that are made after that following year, the deferral amount in respect of the taxpayer's participating interests are

(*a*) for the purpose of clause (i)(C) of the description of B in the definition "deferral amount" in paragraph (1)(*b*), determined as if subsection (4) had not applied to the taxpayer in respect of participating interests for taxation years that ended before that following year; and

(*b*) determined without reference to the application of subsection (13) with regard to dispositions that occurred before that following year.

Superficial dispositions

(17) If a taxpayer disposes of a particular participating interest in an entity, the deferral amount in respect of the particular interest would otherwise be a negative amount and the disposition would, if the particular interest were a capital property and a loss arose on the disposition, give rise to a superficial loss (within the meaning that would be assigned by section 54 if the definition "superficial loss" in that section were read without the reference to subsection 40(3.4) in paragraph (*h*) of that definition)

(*a*) except for the purpose of applying paragraph (*b*) in respect of the disposition, the deferral amount of the taxpayer in respect of the particular interest is deemed to be nil; and

(*b*) the deferral amount of the taxpayer in respect of the property that would be the substituted property referred to in that definition if the assumptions described in this subsection applied is deemed to be equal to the deferral amount of the taxpayer in respect of the particular interest.

Determination of capital dividend account

(18) If an amount (other than an amount determined under subsection (19)) has been included or deducted under subsection (4) in computing the income of a corporation resident in Canada for a particular taxation year in respect of a particular participating interest in a foreign investment entity, in computing the capital dividend account of the corporation

(*a*) the corporation is deemed to have

(i) a capital gain from a disposition at the end of the year of property equal to twice the amount of the taxable capital gain determined under subparagraph (ii), and

(ii) a taxable capital gain from the disposition at the end of the year of property equal to the lesser of

(A) the positive amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of the particular participating interest for the year (if the gross-up factor in respect of the deferral amount is 2), and

(B) the amount included in computing the income of the corporation for the year under subsection (4); and

(*b*) the corporation is deemed to have

(i) a capital loss from a disposition at the end of the year of property equal to twice the amount of the allowable capital loss determined under subparagraph (ii), and

(ii) an allowable capital loss from the disposition at the end of the year of property equal to the lesser of

(A) the absolute value of the negative amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of the particular participating interest for the year (if the gross-up factor in respect of the deferral amount is 2), and

(B) the amount deducted in computing the income of the corporation for the year under subsection (4).

Non-aplication of subsection (4)

(19) No amount shall be included or deducted in computing a taxpayer's income for a taxation year under subsection (4) in respect of a participating interest in a foreign investment entity, if all or substantially all of the amount that, if this Act were read without reference to this subsection, would be required to be included or deducted, as the case may be, in computing the income of the taxpayer for the taxation year under subsection (4) in respect of the particular participating interest can be attributed to

(*a*) capital gains or capital losses from the disposition by the foreign investment entity of capital property;

(*b*) increases or decreases in the fair market value of capital property of the foreign investment entity; or

(*c*) a combination of the factors described in paragraphs (*a*) and (*b*).

Deemed capital gain or loss

(20) If subsection (19) applies in computing a taxpayer's income for a taxation year in respect of a participating interest in a foreign investment entity,

(*a*) the taxpayer is deemed to have a capital gain for the year from the disposition of capital property in the year equal to the amount by which the total of

(i) the amount that would, if this Act were read without reference to subsection (19), be included under subsection (4) in computing the taxpayer's income for the year in respect of the participating interest, and

(ii) the positive amount that is the value of D in the formula in that subsection in respect of the deferral amount in respect of that participating interest for the year (where the gross-up factor in respect of the deferral amount is 2)

exceeds

(iii) the absolute value of the negative amount that is the value of D in the formula in that subsection in respect of the deferral amount in respect of that participating interest for the year (where the gross-up factor in respect of the deferral amount is 2); and

(*b*) the taxpayer is deemed to have a capital loss for the year from the disposition of capital property in the year equal to the amount by which the total of

(i) the amount that would, if this Act were read without reference to subsection (19), be deducted under subsection (4) in computing the taxpayer's income for the year in respect of the participating interest, and

(ii) the absolute value of the negative amount that is the value of D in the formula in that subsection in respect of the deferral amount in respect of that participating interest for the year (where the gross-up factor in respect of the deferral amount is 2)

exceeds

(iii) the positive amount that is the value of D in the formula in that subsection in respect of the deferral amount in respect of that participating interest for the year (where the gross-up factor in respect of the deferral amount is 2).

Definitions and rules of application

94.3 (1) The definitions in subsection 94.1(1), and paragraph 94.2(2)(*a*), apply in this section.

Prevention of double taxation

(2) If a taxpayer resident in Canada receives or becomes entitled to receive a payment from a particular entity or another entity in respect of a participating interest in the particular entity at a particular time in a particular taxation year or a preceding taxation year of the taxpayer,

(*a*) there may be deducted in computing the taxpayer's income for the particular taxation year the lesser of

(i) the amount, if any, by which

(A) the amount included (otherwise than because of subsection 94.2(4)) in computing the taxpayer's income for those years in respect of those payments

exceeds

(B) the total of all amounts each of which is an amount deductible under subsection 91(5) or section 113 in computing

the taxpayer's income for those years in respect of those payments, and

(ii) the amount, if any, by which

(A) the total of all amounts each of which is

(I) an amount in respect of the participating interest that is included, or that would if this Act were read without reference to subsection 94.2(19) have been included, under subsection 94.1(3) or 94.2(4) in computing the taxpayer's income for those years, and

(II) an amount required by subparagraph 94.1(9)(*a*)(ii) to be added in computing the adjusted cost base to the taxpayer of the participating interest at the end of any of those years

exceeds the total of

(B) all amounts each of which is

(I) an amount in respect of the participating interest that is deducted, or that would if this Act were read without reference to subsection 94.2(19) have been deducted, under subsection 94.1(3) or 94.2(4) in computing the taxpayer's income for those years, and

(II) an amount required by subparagraph 94.1(9)(*b*)(ii) to be deducted in computing the adjusted cost base to the taxpayer of the participating interest at the end of any of those years, and

(C) all amounts each of which is an amount deducted under this paragraph in computing the taxpayer's income in respect of those payments; and

(*b*) if the interest is capital property at the particular time, in computing the adjusted cost base to the taxpayer of the interest after the particular time there shall be deducted the amount deducted under paragraph (*a*) in computing the taxpayer's income.

(2) Subsection (1) applies to taxation years that begin after 2001, except that

(*a*) subsection 94.2(10) of the Act, as enacted by subsection (1), does not apply to taxation years that begin before 2003; and

(*b*) an election referred to in paragraph 94.1(4)(*a*) or (12)(*e*) of the Act, as enacted by subsection (1), made by a taxpayer is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act is assented to.

12. (1) The portion of subsection 95(1) of the Act before the definition "active business" is replaced by the following:

Definitions re foreign affiliates

95. (1) In this subdivision (other than sections 94 to 94.3),

(2) The portion of the definition "controlled foreign affiliate" in subsection 95(1) of the Act before paragraph (*a*) is replaced by the following:

"controlled foreign affiliate"
« société étrangère affiliée contrôlée »

"controlled foreign affiliate", at any time, of a taxpayer resident in Canada means a foreign affiliate of the taxpayer that is, at that time, a controlled foreign affiliate of the taxpayer because of subsection 94.1(12) or that is, at that time, controlled by

(3) The formula in the definition "foreign accrual property income" in subsection 95(1) of the Act is replaced by the following:

$$(A + A.1 + A.2 + B) - (D + E + F + G + H)$$

(4) The description of C in the definition "foreign accrual property income" in subsection 95(1) of the Act is repealed.

(5) Subparagraph (*a*)(i) of the definition "investment business" in subsection 95(1) of the Act is replaced by the following:

(i) a business carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of the country under whose laws the affiliate was formed, organized, continued or exists and is governed and of each country in which the business is carried on,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is controlled by a non-resident corporation, of the country under whose laws the controlling corporation is formed, organized, continued or exists and is governed, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, or

(6) The definition "relevant tax factor" in subsection 95(1) of the Act is replaced by the following:

"relevant tax factor"
« facteur fiscal
approprié »

"relevant tax factor" of a person or partnership for a taxation year means

(*a*) in the case of a corporation (or a partnership all the members of which, other than non-resident persons, are corporations), the quotient obtained when 1 is divided by the percentage set out in paragraph 123(1)(*a*) in respect of the year; and

(*b*) in any other case, 2.

(7) Subsection 95(2) of the Act is amended by adding the following after paragraph (*g*.2):

(*g*.3) in computing the foreign accrual property income of a particular foreign affiliate of a particular taxpayer for a particular taxation year of the particular affiliate, sections 94.1 to 94.3 apply to the particular affiliate as if

(i) the particular affiliate were a taxpayer resident in Canada throughout the particular taxation year (other than for the purposes of determining if the particular affiliate is a foreign affiliate of a taxpayer or if the particular affiliate is a foreign investment entity and a participating interest in the particular affiliate is an exempt interest of a taxpayer in a foreign investment entity),

(ii) the words "controlled foreign affiliate of the taxpayer" in paragraph (*a*) of the definition "exempt interest" in subsection

94.1(1) referred to a controlled foreign affiliate of the particular taxpayer and not to a controlled foreign affiliate of the particular affiliate,

(iii) the form referred to in paragraph (*c*) of the description of A in subsection 94.1(5) and any other information or notification in respect of participating interests in a foreign investment entity held by the particular affiliate required to be filed or included in the particular affiliate's return of income for the particular year were required to be filed or included with, and only with, the particular taxpayer's return of income for the particular taxpayer's taxation year in which the affiliate's particular year ends,

(iv) designations, information and notifications made by the particular taxpayer in the form referred to in subparagraph (iii) were made by the particular affiliate,

(v) the words "the particular taxpayer" in paragraph (*g*) of the description of A in subsection 94.1(5) referred to the particular taxpayer rather than to the particular affiliate,

(vi) each reference to "foreign affiliate" and "affiliate" in paragraph (*g*) of the description of A in subsection 94.1(5) were a reference to a foreign affiliate of the particular taxpayer and not to a foreign affiliate of the particular affiliate,

(vii) subsection 94.1(5) were read without reference to paragraph (*i*) of the description of A in subsection 94.1(5),

(viii) for the purpose of applying sections 94.1 and 94.2 in computing the income of a foreign investment entity in which the particular affiliate holds a participating interest,

(A) the words "controlled foreign affiliate of the taxpayer" in paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1) referred to a controlled foreign affiliate of the particular taxpayer and not to a controlled foreign affiliate of the entity, and

(B) the fresh-start year of the entity in respect of the particular affiliate were a taxation year of the entity

(I) that ends in a taxation year of the particular affiliate that begins after 2001,

(II) that begins immediately after a preceding taxation year of the entity at the end of which

1. the entity was not a foreign investment entity,

2. the particular affiliate did not hold a participating interest in the entity (other than an exempt interest), or

3. the particular affiliate was not a controlled foreign affiliate of the taxpayer,

(III) at the end of which the entity is a foreign investment entity in which the particular affiliate holds a participating interest that is not an exempt interest, and

(IV) at any time in which the particular affiliate is a controlled foreign affiliate of the particular taxpayer,

(ix) an election under paragraph 94.1(4)(*a*) or clause (i)(C) of the description of D in paragraph 94.2(4)(*a*) for the particular year were required to be filed under that provision in respect of the particular affiliate, by, and only by, the particular taxpayer, with the Minister on or before the filing-due date of the particular taxpayer for the particular taxpayer's taxation year in which the particular year ends,

(x) the amount determined under paragraph 94.2(1)(*b*) did not include the portion of that amount that can reasonably be considered to have accrued during the period that the particular affiliate was not a foreign affiliate of any person described in any of subparagraphs (*f*)(iii) to (vii),

(xi) the reference in subsection 94.2(18) to the expression "in computing the capital dividend account of the corporation" were read in respect of the particular affiliate as a reference to the expression "in computing the amount prescribed to be the particular affiliate's exempt surplus and taxable surplus in respect of the taxpayer", and

(xii) subsection 94.1(4) were read without reference to paragraph (*e*);

(8) Subparagraph 95(2)(*l*)(iii) of the Act is replaced by the following:

(iii) the business is carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of the country under whose laws the affiliate was formed, organized, continued or exists and is governed and of each country in which the business is carried on,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is controlled by a non-resident corporation, of the country under whose laws the controlling corporation is formed, organized, continued or exists and is governed, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, and

(9) Paragraph 95(2.4)(*a*) of the Act is replaced by the following:

(*a*) the income is derived by the affiliate in the course of a business conducted principally with persons with whom the affiliate deals at arm's length carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(i) of the country in which the affiliate was formed, continued or exists and is governed and of each country in which the business is carried on,

(ii) of the country in which the business is principally carried on, or

(iii) where the affiliate is controlled by a corporation, of the country under the laws of which the controlling corporation is formed, continued or exists and is governed, where those regulating laws are recognized under the laws of the country in which the business in principally carried on and both those countries are members of the European Union; and

(10) Subsections (1) to (5) and (7) to (9) apply to taxation years of foreign affiliates of taxpayers that begin after 2001.

(11) Subsection (6) applies after 2001.

13. (1) Section 96 of the Act is amended by adding the following after subsection (1.8):

Application of sections 94.1 and 94.2

(1.9) Where an exempt taxpayer (as defined in subsection 94.1(1)) for a taxation year is a member of a partnership at any time in the year, for the purposes of applying paragraphs (1)(*f*) and (*g*) and 53(1)(*e*) and 2(*c*) to the taxpayer for a fiscal period of the partnership that ends in the year this Act shall be read without reference to sections 94.1 and 94.2.

(2) The portion of subsection 96(3) of the Act before paragraph (*a*) is replaced by the following:

Agreement or election of partnership members

(3) Where a taxpayer who was a member of a partnership at any time in a fiscal period has, for any purpose relevant to the computation of the taxpayer's income from the partnership for the fiscal period, made or executed an agreement, designation or election under or in respect of the application of any of subsections 13(4) and (16) and 14(6), section 15.2, subsections 20(9) and 21(1) to (4), section 22, subsection 29(1), section 34, clause 37(8)(*a*)(ii)(B), subsections 44(1) and (6), 50(1) and 80(5), (9), (10) and (11), section 80.04, paragraph (*b*) of the definition "carrying value in subsection 94.1(1), subsections 94.1(4), (5) and (12), clause (i)(C) of the description of D in paragraphs 94.2(4)(*a*) and 95(2)(*g*.2) and (*g*.3) and subsections 97(2), 139.1(16) and (17) and 249.1(4) and (6) that, if this Act were read without reference to this subsection, would be a valid agreement, designation or election,

(3) Subsection 96(9) of the Act is replaced by the following:

Application of foreign partnership rule

(9) For the purposes of applying subsection (8) and this subsection,

(*a*) where it can reasonably be considered that one of the main reasons that a member of a partnership is resident in Canada is to avoid the application of subsection (8), the member is deemed not to be resident in Canada; and

(*b*) where at any time a particular partnership is a member of another partnership,

(i) each person or partnership that is, at that time, a member of the particular partnership is deemed to be a member of the other partnership at that time,

(ii) each person or partnership that becomes a member of the particular partnership at that time is deemed to become a member of the other partnership at that time, and

(iii) each person or partnership that ceases to be a member of the particular partnership at that time is deemed to cease to be a member of the other partnership at that time.

(4) Subsections (1) and (2) apply to fiscal periods that begin after 2001.

(5) Subsection (3) applies to fiscal periods that begin after June 22, 2000.

14. (1) Section 104 of the Act is amended by adding the following after subsection (4):

Mark-to-market property

(4.1) In determining whether property is capital property for the purpose of subsection (4), this Act shall be read without reference to subparagraph 39(1)(*a*)(ii.3) and section 94.2.

(2) The portion of subsection 104(6) of the Act before paragraph (*a*) is replaced by the following:

Deduction in computing income of trust

(6) Subject to subsections (7) and (7.01), for the purposes of this Part, there may be deducted in computing the income of a trust for a taxation year

(3) Section 104 of the Act is amended by adding the following after subsection (7):

Trusts deemed to be resident in Canada

(7.01) Where a trust is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust's income for the year, the maximum amount deductible under subsection (6) in computing its income for the year is the amount, if any, by which

(*a*) the maximum amount that, if this Act were read without reference to this subsection, would be deductible under subsection (6) in computing its income for the year,

exceeds the lesser of

(*b*) the total of

(i) the designated income of the trust for the year (within the meaning assigned by subsection 210.2(2)), and

(ii) all amounts each of which is 50% of an amount paid or credited in the year to the trust that would, if this Act were read without reference to subparagraph 94(3)(*a*)(v) and sections 216 and 217, be an amount as a consequence of the payment or crediting of which the trust would have been liable to tax under Part XIII, and

(*c*) the maximum amount that would be deductible in computing its income for the year if this section were read without reference to this subsection and if the only amounts that became payable in the year to a beneficiary were amounts that became payable in the year to

(i) a partnership (other than a partnership that is a Canadian partnership on the day that would be determined under paragraph 214(3)(*f*) in respect of the amount if the assumptions set out in subparagraph (*b*)(ii) applied), or

(ii) an entity (within the meaning assigned by subsection 94(1)) that is non-resident on the day that would be determined under paragraph 214(3)(*f*) in respect of the amount if the assumptions set out in subparagraph (*b*)(ii) applied.

(4) Paragraph 104(21.3)(*a*) of the Act is replaced by the following:

(*a*) the total of all amounts each of which is an allowable capital loss (other than an allowable business investment loss) of the trust for the year from the disposition of a capital property, and

(5) Subsection 104(24) of the Act is replaced by the following:

Amount payable

(24) For the purposes of subparagraph 53(2)(*h*)(i.1), paragraph (*h*) of the definition "exempt foreign trust" in subsection 94(1), paragraph (*c*) of the definition "specified charity" in subsection 94(1), subsection 94(8) and subsections (6), (7), (7.01), (13) and (20), an amount is deemed not to have become payable to a beneficiary in a taxation year unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of it.

(6) Subsection (1) applies to trust taxation years that begin after 2001.

(7) Subsections (2), (3) and (5) apply to trust taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the trust taxation year begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

(8) Subsection (4) applies to trust taxation years that begin after 2000.

15. (1) The portion of subsection 108(3) of the Act before paragraph (*a*) is replaced by the following:

Income of a trust in certain provisions

(3) For the purposes of the definition "income interest" in subsection (1) and the definition "exempt foreign trust" in subsection 94(1), the income of a trust is its income computed without reference to the provisions of this Act and, for the purposes of the definition "pre-1972 spousal trust" in subsection (1) and paragraphs 70(6)(*b*) and (6.1)(*b*), 73(1.01)(*c*) and 104(4)(*a*), the income of a trust is its income computed without reference to the provisions of this Act, minus any dividends included in that income

(2) Subsection (1) applies to trust taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the trust taxation year begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

16. (1) Clause 113(1)(*b*)(i)(A) of the Act is replaced by the following:

(A) the corporation's relevant tax factor for the year

(2) Clause 113(1)(*c*)(i)(B) of the Act is replaced by the following:

(B) the corporation's relevant tax factor for the year, and

(3) Subsections (1) and (2) apply after 2001.

17. (1) The portion of section 114 of the Act before paragraph (*a*) is replaced by the following:

Individual resident in Canada for only part of year

114. Notwithstanding subsection 2(2) and subject to subsection 94.2(5), the taxable income for a taxation year of an individual who is resident in Canada throughout part of the year and non-resident throughout another part of the year is the amount, if any, by which

(2) Subsection (1) applies to taxation years that begin after 2001.

18. (1) Subsection 122(2) of the Act is amended by striking out the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*d*.1) was not a trust to which a contribution, within the meaning assigned by section 94, was made after June 22, 2000; and

(2) Subsection (1) applies to taxation years that begin after 2001.

19. (1) Paragraph 149(10)(*c*) of the Act is replaced by the following:

(*c*) for the purposes of applying sections 37, 65 to 66.4, 66.7, 94.1 to 94.3, 111 and 126, subsections 127(5) to (35) and section 127.3 to the corporation, the corporation is deemed to be a new corporation the first taxation year of which began at that time; and

(2) Subsection (1) applies to each corporation that, after 2001, becomes or ceases to be exempt from tax on its taxable income under Part I of the Act.

20. (1) Subparagraph 152(4)(*b*)(vi) of the Act is replaced by the following:

(vi) is made in order to give effect to the application of subsection 94(9) or (11) or 118.1(15) or (16).

(2) Subsection (1) applies to taxpayer taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the taxation year begins in 2001 and section 94 of the Act, as enacted by subsection 10(1) of this Act, applies in respect of the taxpayer because a trust makes a valid election under paragraph 10(2)(*a*) of this Act.

21. (1) Paragraph (*d*) of the description of A in subsection 162(10.1) of the Act is replaced by the following:

(*d*) where the return is required to be filed under section 233.2 in respect of a trust, 5% of the total of all amounts each of which is the fair market value, at the time it was made, of a contribution of the person or partnership made to the trust before the end of the last taxation year of the trust in respect of which the return is required,

(2) Section 162 of the Act is amended by adding the following after subsection (10.1):

Application to trust contributions

(10.11) In paragraph (*d*) of the description of A in subsection (10.1), subsections 94(1) and (2) apply, except that the definition "arm's length transfer" in subsection 94(1) shall be read without reference to paragraph (*e*) of that definition.

(3) The portion of subsection 162(10.3) of the Act before paragraph (*a*) is replaced by the following:

Application to partnerships

(10.3) For the purposes of paragraph (*f*) of the description of A in subsection (10.1) and subsection (10.2), in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a partnership,

(4) Subsection 162(10.4) of the Act is repealed.

(5) Subsections (1) to (4) apply to returns in respect of taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the return relates to a trust the taxation year of which begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

22. (1) Paragraph 163(2.4)(*b*) of the Act is replaced by the following:

(*b*) where the return is required to be filed under section 233.2 in respect of a trust, the greater of

(i) $24,000, and

(ii) 5% of the total of all amounts each of which is the fair market value, at the time it was made, of a contribution of the person or partnership made to the trust before the end of the last taxation year of the trust in respect of which the return is required;

(2) Section 163 of the Act is amended by adding the following after subsection (2.4):

Application to trust contributions

(2.41) In subparagraph (2.4)(*b*)(ii), subsections 94(1) and (2) apply, except that the definition "arm's length transfer" in subsection 94(1) shall be read without reference to paragraph (*e*) of that definition.

(3) The portion of subsection 163(2.6) of the Act before paragraph (*a*) is replaced by the following:

Application to partnerships

(2.6) For the purposes of paragraph (2.4)(*d*) and subsection (2.5), in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a partnership,

(4) Subsection 163(2.91) of the Act is repealed.

(5) Subsections (1) to (4) apply to returns in respect of taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the return relates to a trust the taxation year of which begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

23. (1) The definitions "specified beneficiary" and "specified foreign trust" in subsection 233.2(1) of the Act are repealed.

(2) Subsections 233.2(2) and (3) of the Act are replaced by the following:

Rule of application

(2) In this section and paragraph 233.5(*c*.1), subsections 94(1) and (2) apply, except that the definition "arm's length transfer" in subsection 94(1) shall be read without reference to paragraph (*e*) of that definition.

(3) Subsection 233.2(4) of the Act is replaced by the following:

Filing information on foreign trusts

(4) A person shall file an information return in prescribed form, in respect of a taxation year of a particular trust (other than an exempt trust or a trust described in any of paragraphs (*c*) to (*i*) of the definition "exempt foreign trust" in subsection 94(1)), with the Minister on or before the person's filing-due date for the person's taxation year in which the particular trust's taxation year ends if

(*a*) a contribution has been made by the person to the particular trust at any time in the taxation year of the particular trust or in a preceding taxation year of the particular trust;

(*b*) the person is

(i) resident in Canada at the end of the particular trust's taxation year, and

(ii) not, at the end of the year,

(A) a mutual fund corporation,

(B) a non-resident-owned investment corporation,

(C) a person (other than a trust) all of whose taxable income for the person's taxation year that includes that time is exempt from tax under Part I,

(D) a trust all of the taxable income of which for its taxation year that includes that time is exempt from tax under Part I,

(E) a mutual fund trust,

(F) a trust described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1),

(G) a registered investment,

(H) a trust in which all persons beneficially interested are persons described in clauses (A) to (G), or

(I) a person who is a contributor to the particular trust by reason only of being a contributor to a trust described in any of clauses (D) to (H); and

(*c*) the particular trust is not resident in Canada at the end of its taxation year.

Similar arrangements

(4.1) In this section and sections 162, 163 and 233.5, a person's obligations under subseuction (4) (except to the extent that they are waived in writing by the Minister) are to be determined as if a transfer were a contribution to which paragraph (4)(*a*) applied, an arrangement or entity were a trust not resident in Canada throughout the calendar year that includes the time referred to in paragraph (*a*) and a taxation year of the arrangement or entity were that calendar year, if

(*a*) the person at any time, directly or indirectly, transferred or loaned the property to be held

(i) under the arrangement and the arrangement is governed by laws that are not laws of Canada or a province, or

(ii) by the entity and the entity is a non-resident entity (within the meaning assigned by subsection 94.1(1));

(*b*) the transfer or loan is not an arm's length transfer;

(*c*) the transfer or loan is not solely in exchange for property that would be described in paragraphs (*a*) to (*i*) of the definition "specified foreign property" in subsection 233.3(1) if that definition were read without reference to paragraphs (*j*) to (*q*);

(*d*) the arrangement or entity is not a trust in respect of which the person would, if this Act were read without reference to this subsection, be required to file an information return for a taxation year that includes that time; and

(*e*) the arrangement or entity is, for a taxation year or fiscal period of the arrangement or entity that includes that time, not

(i) an exempt foreign trust,

(ii) a foreign affiliate in respect of which the person is a reporting entity (within the meaning assigned by subsection 233.4(1)), or

(iii) an exempt trust.

(4) Subsections (1) to (3) apply to returns in respect of trust taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the trust taxation year begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

24. (1) Paragraph (*d*) of the definition "specified foreign property" in subsection 233.3(1) of the Act is replaced by the following:

(*d*) an interest in a non-resident trust or in a trust that, if this Act were read without reference to subparagraph 94(3)(*a*)(iii), would be non-resident,

(2) The definition "specified foreign property" in subsection 233.3(1) of the Act is amended by adding the following after paragraph (*d*):

(*d*.1) an interest in an insurance policy that is deemed by subsection 94.2(10) to be a participating interest in a non-resident entity,

(3) Paragraph (*l*) of the definition "specified foreign property" in subsection 233.3(1) of the Act is repealed.

(4) Paragraph (*m*) of the definition "specified foreign property" in subsection 233.3(1) of the Act is replaced by the following:

(*m*) an interest in a non-resident trust (or in a trust that, if this Act were read without reference to subparagraph 94(3)(*a*)(iii), would be non-resident) that was not acquired for consideration by the person or partnership or by a person related to the person or partnership,

(5) Subsections (1), (3) and (4) apply to interests in a trust held at any time in trust taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the trust taxation year begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

(6) Subsection (2) applies to returns for taxation years that begin after 2001.

25. (1) Subsection 233.4(1) of the Act is amended by adding the word "and" at the end of paragraph (*a*) and by repealing paragraph (*b*).

(2) Subparagraph 233.4(1)(*c*)(ii) of the Act is replaced by the following:

(ii) of which a non-resident corporation is a foreign affiliate at any time in the fiscal period.

(3) The portion of subsection 233.4(2) of the Act before paragraph (*a*) is replaced by the following:

Rules of application

(2) For the purpose of this section, in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a taxpayer resident in Canada or of a partnership

(4) Subsections (1) to (3) apply to taxation years and fiscal periods that begin

(*a*) after 2001; and

(*b*) in 2001, if the taxation year or fiscal period relates to a trust the taxation year of which begins in 2001 and the trust makes a valid election under paragraph 10(2)(*a*) of this Act.

26. (1) Paragraph 233.5(*c*) of the Act is replaced by the following:

(*c*) if the return is required to be filed under section 233.2 in respect of a trust, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 and before June 23, 2000 that gave rise to the requirement to file a return for a taxation year of the trust that began before 2002 or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2 in respect of each taxation year of the trust that began before 2002;

(*c*.1) if the return is required to be filed under section 233.2, at the time of each contribution (determined with reference to subsection 233.2(2)) made by the person or partnership after June 22, 2000 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2;

(*c*.2) if the return is required to be filed under section 233.4 by a person or partnership in respect of a corporation that is a controlled foreign affiliate for the purpose of that section of the person or partnership, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.4; and

(2) Subsection (1) applies to returns in respect of taxation years that begin

(*a*) after 2001; and

(*b*) in 2001, if the taxation year is a taxation year that begins in 2001 of a trust and the trust makes a valid election under paragraph 10(2)(*a*)* of this Act, in which case the reference in paragraph 233.5(c) of the Act, as enacted by subsection (1), to "2002" is to be read as a reference to "2001".

27. (1) The definition "cost amount" in subsection 248(1) of the Act is amended by adding the following after paragraph (*c*.1):

(*c*.2) where the cost at that time to the taxpayer of the property is determined under subsection 94.2(12), the cost so determined,

(2) The definition "inventory" in subsection 248(1) of the Act is replaced by the following:

"inventory"
« inventaire »

"inventory" means a description of property (other than property to which subsection 94.2(3) applies) the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year or would have been so relevant if the income from the business had not been computed in accordance with the cash method and, with respect to a farming business, includes all of the livestock held in the course of carrying on the business;

(3) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"foreign accrual property income"
« revenu étranger accumulé, tiré de biens »

"foreign accrual property income" has the meaning assigned by section 95;

"non-discretionary trust"
« fiducie non discrétionnaire »

"non-discretionary trust" has the meaning assigned by subsection 17(15).

(4) Subsections (1) and (3) apply after 2001.

(5) Subsection (2) applies to fiscal periods that begin after 2001.

Explanatory Notes

PREFACE

These explanatory notes described proposed amendments to the *Income Tax Act*. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act*. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Clause 1

Income from Business or Property – Controlled Foreign Affiliate

ITA
12(1)(*k*)

Section 12 of the *Income Tax Act* provides for the inclusion of various amounts in computing a taxpayer's income for a taxation year from business or property. Paragraph 12(1)(*k*) refers to certain dividends required by existing sections 90 to 95 to be so added.

Paragraph 12(1)(*k*) is amended so that it refers to all amounts required to be added in computing income under amended sections 90 to 95, including new sections 94 to 94.2.

This amendment generally applies to taxation years that begin after 2001. Where a trust created in 2001 elects to have new section 94 apply to its 2001 taxation years, this provision will also apply for those years.

Clause 2

Loan to Non-resident – Controlled Foreign Affiliate

ITA
17(15)

Subsection 17(15) of the Act defines expressions that apply for the purposes of section 17, which provides rules under which imputed interest, in connection with debt owing to a taxpayer from a non-resident person, is included in computing the taxpayer's income. The expression "controlled foreign affiliate" is defined to have the same meaning as it does under subsection 95(1) of the Act, except that for the purpose of section 17, a non-resident corporation must be controlled by Canadian residents in order to be treated as a controlled foreign affiliate of a taxpayer resident in Canada.

The definition "controlled foreign affiliate" in subsection 17(15) is amended so that new subsection 94.1(12) does not apply for the purposes of section 17. Under that new subsection, an election is

available so that a foreign affiliate of a taxpayer is treated as a controlled foreign affiliate of the taxpayer.

This amendment applies after 2001.

Clause 3

Capital Gain from Disposition of Property

ITA
39(1)(*a*)(ii.3)

Paragraph 39(1)(*a*) of the Act describes a taxpayer's capital gain for a taxation year from the disposition of property. This paragraph provides that gains from dispositions of specified properties are to be excluded in determining a capital gain. Under subparagraph 39(1)(*a*)(ii.2), the specified properties include specified debt obligations, where subsection 142.4(4) or (5) applies to the disposition, and mark-to-market properties where subsection 142.5(1) applies to the disposition. Under subparagraph 39(1)(*b*)(ii), the same exclusion generally applies with regard to a taxpayer's capital loss.

New subparagraph 39(1)(*a*)(ii.3) provides a similar exclusion for property in respect of which new subsection 94.2(3) applies to a taxpayer immediately before the time of the disposition. Subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities. Because of paragraph 94.2(5)(*b*), this exclusion does not apply where the taxpayer is not resident in Canada immediately before the time of the disposition.

This amendment applies to dispositions that occur after 2001.

Clause 4

Adjustments to Cost Base

ITA
53

Section 53 of the Act sets out rules for determining the adjusted cost base of capital property for the purposes of calculating any capital gain or loss on its disposition. Certain adjustments to cost are made under this section. Subsection 53(1) provides for additions to cost and subsection 53(2) for deductions from cost.

ITA
53(1)(*d*.1)

Paragraph 53(1)(*d*.1) of the Act, applied together with existing paragraph 94(5)(*a*), provides for an addition in computing the adjusted cost base (ACB) to a taxpayer of the taxpayer's capital interest in a trust to which existing paragraph 94(1)(*d*) applies. Paragraph 53(1)(*d*.1) is amended to ensure that historical ACB additions are maintained, notwithstanding the replacement of the rules in existing section 94.

This amendment applies after 2001.

ITA
53(1)(*m*) and (*m*.1)

Paragraph 53(1)(*m*) of the Act provides for an addition in computing the ACB to a taxpayer of "offshore investment fund property" to which existing section 94.1 applies. It is amended to ensure that the historical ACB additions are maintained, notwithstanding the replacement of the rules in existing section 94.1.

Paragraph 53(1)(*m*.1) is introduced to provide for the ACB additions contemplated by new subsections 94.1(9) and 94.2(11). For more detail, see the commentary on those subsections.

These amendments apply after 2001.

ITA
53(2)(*w*)

Paragraph 53(2)(*w*) of the Act is introduced to provide for the ACB reductions contemplated by new subsections 94.1(9), 94.2(11) and 94.3(2). For more detail, see the commentary on those subsections.

New paragraph 53(2)(*w*) applies after 2001.

Clause 5

Death of a Taxpayer

ITA
70(3.1)

Under subsection 70(2) of the Act, the value of certain "rights or things" owned by an individual at the time of the individual's death is required to be included in the individual's income for the year of death. Subsection 70(3) provides that this rule does not apply in connection with "rights or things" transferred to beneficiaries of the deceased within a specified period of time. Subsection 70(3.1) provides that certain property does not constitute a "right or thing" for this purpose.

Subsection 70(3.1) is amended so that a "right or thing" does not include property in respect of which new subsection 94.2(3) applied to the individual immediately before the individual's death. New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.

This amendment applies to the 2002 and subsequent taxation years.

ITA
70(5.2)(*e*)

Subsection 70(5.2) of the Act provides rules with respect to the disposition of resource properties and land inventories on death.

Paragraph 70(5.2)(*e*) is introduced to provide for a deemed disposition, immediately before the death of an individual, of an interest in a foreign investment entity held by the individual. Paragraph 70(5.2)(*e*) applies only to an interest in a foreign investment entity in respect of which new subsection 94.2(3) applied to the deceased immediately before death. (New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.)

A disposition under paragraph 70(5.2)(*e*) is deemed to occur for proceeds of disposition equal to the fair market value, at the time of the deemed disposition, of the interest in the foreign investment entity. That paragraph also provides that the acquisition by another person of the interest as a consequence of the individual's death is deemed to be at a cost equal to that fair market value. The proceeds of disposition are included in the value of A in the formula in paragraph 94.2(4)(*a*) in computing the deceased's income under subsection 94.2(4) for the taxation year of death. The deceased is treated as not having held the interest after death.

This amendment applies to the 2002 and subsequent taxation years.

Clause 6

Trusts – Attribution

ITA
75(2) and (3)

Subsection 75(2) generally provides for the attribution of income derived from certain trust property to a person resident in Canada where the property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person). Subsection 75(3) exempts certain trusts from this attribution rule.

Subsection 75(2) is amended to ensure that, if the person to whom income from a particular property would otherwise be attributed under that subsection is an otherwise non-resident trust that is deemed

by new subsection 94(3) to be resident in Canada, the income from that property will not be attributed back to the person.

Amended subsection 75(2) generally applies to trust taxation years that begin after 2001. Where a trust created in 2001 elects to have new section 94 apply to its 2001 taxation years, this provision will also apply for those years.

Subsection 75(3) is amended by adding new paragraph 75(3)(*c*.2). New paragraph 75(3)(*c*.2) ensures that subsection 75(2) does not apply to a trust that is not deemed, under new subsection 94(3), to be resident in Canada for the purposes of computing its income for its taxation year, provided that the reason the trust is not deemed to be resident is because a contributor to the trust is an individual (other than a trust) who was, at the end of the trust's taxation year, resident in Canada for a period or periods the total of which is not more than 60 months. In effect, this exception will generally apply to trusts in respect of which the contributors are recent immigrants to Canada (i.e., resident in Canada for not more than 60 months). The exception is consistent with similar 60-month exemptions in:

- section 94 (see subsection 94(3) and the definitions "connected contributor" and "resident contributor" in subsection 94(1)),

- section 94.1 (see subsection 94.1(2) and the definition "exempt taxpayer" in subsection 94.1(1)), and

- section 94.2 (see subparagraph 94.2(3)(*b*)(*i*)).

New paragraph 75(3)(*c*.2) applies to trust taxation years that begin after 2000 except that, in respect of trust taxation years that begin in 2001, paragraph 75(3)(*c*.2) applies with reference to subsection 94(1) as it reads in 2002.

Clause 7

Definition of "Eligible Property"

ITA
85(1.1)(*g*)

Subsection 85(1.1) of the Act describes the types of property (which are referred to as "eligible property") that may be transferred to a corporation under subsection 85(1). Eligible property includes certain capital property described in the subsection, as well as additional property.

Subsection 85(1.1) is amended so that eligible property for a taxpayer, in all cases, excludes property in respect of which new subsection 94.2(3) applies to the taxpayer. New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.

This amendment applies after 2001.

Clause 8

Amalgamations – Non-resident Trusts and Foreign Investment Entities

ITA
87(2)(*j*.95)

Section 87 of the Act sets out rules that apply on the amalgamation of two or more taxable Canadian corporations. The amalgamated corporation is generally treated as a continuation of the predecessor corporations for the purposes of the Act.

New paragraph 87(2)(*j*.95) provides that, where there has been an amalgamation of two or more taxable Canadian corporations, the amalgamated corporation is deemed to be a continuation of its predecessor corporations for the purposes of sections 94 to 94.3, which relate to foreign trusts and foreign investment entities. Thus, for example, an amalgamated corporation will be considered to be a

"contributor" to a trust (as defined in subsection 94(1)) if any predecessor corporation was a contributor to the trust. In addition, the new corporation's "deferral amount" under paragraph 94.2(1)(*b*) in respect of an interest in a foreign investment entity will be determined in the same manner as a predecessor's "deferral amount" in respect of the same interest.

Because of the operation of paragraph 88(1)(*e*.2), new paragraph 87(2)(*j*.95) also applies to windings-up to which section 88 applies.

This amendment applies after 2001.

Clause 9

Amounts to be Included in Respect of Share of a Foreign Affiliate

ITA
91

Section 91 of the Act sets out rules for determining amounts that a taxpayer resident in Canada is to include in computing its income for a particular year as income from a share of a controlled foreign affiliate of the taxpayer.

ITA
91(1)

Subsection 91(1) of the Act provides that a taxpayer that is resident in Canada must include in computing income an amount in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer.

Subsection 91(1) is amended so that it does not result in additional income for a taxpayer arising because of the ownership by the taxpayer (or a controlled foreign affiliate of the taxpayer) of shares that are "tracked interests" subject to the mark-to-market regime in section 94.2 by reason of the application of subsection 94.2(9). Note that, because of paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1), a share of the capital stock of a controlled foreign affiliate is otherwise not subject to the regime for foreign investment entities in new sections 94.1 and 94.2.

This amendment applies to trust taxation years that begin after 2001.

ITA
91(4)

Subsection 91(4) of the Act provides for a deduction in computing the income of a taxpayer resident in Canada. The deduction is available to a taxpayer where the taxpayer has included an amount under subsection 91(1) in computing income in respect of a share of the capital stock of a controlled foreign affiliate of the taxpayer. The deduction is generally determined with reference to foreign taxes payable by the affiliate and a "relevant tax factor". The "relevant tax factor" for a resident taxpayer is designed to permit a deduction for the resident taxpayer to result in tax relief that is representative of foreign taxes payable by a controlled foreign affiliate of the resident taxpayer.

Subsection 91(4) is amended to explicitly link the "relevant tax factor" to the resident taxpayer and the taxation year for which the deduction under subsection 91(4) is claimed. This is consistent with the more explicit definition of "relevant tax factor" described below in the commentary on subsection 95(1).

This amendment applies after 2001.

Clause 10

Non-resident Trusts

ITA
94

OVERVIEW

Existing Rules

Section 94 of the Act sets out rules that tax the passive income earned by certain non-resident trusts. Section 94 generally applies if a person resident in Canada has transferred or loaned property to a

non-resident trust that has one or more beneficiaries that are resident in Canada.

Section 94 uses two different methods to impose tax, depending on whether the trust is a discretionary trust. A discretionary trust is a trust under which a person has a discretionary power to determine the amount of the income or capital of the trust that one or more beneficiaries will receive.

If the non-resident trust is a discretionary trust, paragraph 94(1)(*c*) deems the trust to be resident in Canada for the purposes of Part I of the Act and deems its income for tax purposes to be the total of its Canadian source income and its foreign accrual property income, if any. Each beneficiary is jointly and severally liable to pay the Canadian tax of the trust. However, the liability can be enforced against a particular beneficiary only to the extent that the beneficiary has received a distribution from the trust or proceeds from the sale of an interest in the trust.

If the non-resident trust is not a discretionary trust, paragraph 94(1)(*d*) provides that it is to be treated in much the same manner that a non-resident corporation is treated. If a Canadian resident beneficiary holds an interest in the trust with a fair market value equal to 10% or more of the total fair market value of all beneficial interests in the trust, the trust is deemed to be a controlled foreign affiliate of the beneficiary. Consequently, the foreign accrual property income rules apply to the trust and the beneficiary, requiring the beneficiary to include a portion of the foreign accrual property income of the trust in income. On the other hand, beneficiaries whose beneficial interests are less than 10% of the total fair market value of all interests in the trust may be subject to tax under the offshore investment fund rules in section 94.1. If section 94.1 does not apply, such beneficiaries are taxed only if trust income becomes payable to them in the year in which it arises.

New Rules

New section 94 of the Act takes a different approach to the taxation of non-resident trusts (NRTs). In general, if a Canadian resident contributes property to a non-resident trust, the contributor, the non-resident trust and certain Canadian resident beneficiaries of the trust may all become jointly and severally and solidarily liable to pay

Canadian tax on the world-wide income of the trust. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Except as indicated otherwise, the amendments to section 94 apply to trust taxation years that begin after 2001. In addition, a trust created in 2001 may elect in writing (by filing the election with the Minister on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

The table below briefly summarizes section 94 and related rules.

Issue	Summary	References
1. Which trusts are subject to the new NRT rules?	A. In general, a trust (other than an exempt foreign trust) will be subject to tax for a taxation year as a trust resident in Canada if a contribution was made to the trust by an entity that is resident in Canada at the end of the year (other than a recent immigrant to Canada).	S. 94(3) "entity" – s. 94(1) "exempt foreign trust" – s. 94(1) "contribution" – s. 94(1) and (2) "resident contributor" – s. 94(1) As to 60-month test for new immigrants, see definition "resident contributor" in s. 94(1).
	B. In addition, a trust (other than an exempt foreign trust) will generally be subject to Canadian tax for a taxation year if • the contribution was made by an entity when the entity was resident in Canada (or generally within a 60-month period before the entity became resident in Canada or within a 60-month period after the entity ceased to be resident in Canada), • where the entity is an individual (other than a trust), by the end of the year the individual had been resident in Canada for more than 60 months, and • at the end of the year there is an entity (other than a specified charity or testamentary beneficiary) that is resident in Canada and is a beneficiary under the trust.	S. 94(3) and (11) "beneficiary" – s. 94(1) "contribution" – s. 94(1) and (2) "connected contributor" – s. 94(1) "entity" – s. 94(1) "non-resident time" - 94(1) "resident beneficiary" – s. 94(1) "specified charity" – s. 94(1) "testamentary beneficiary" – s. 94(1)

Issue	Summary	References
2. Who is responsible for the tax payable by an NRT?	The trust is required to pay tax. If it fails to do so, each contributor referred to in 1(A) and/or each beneficiary referred to in 1(B) is jointly and severally and solidarily liable with the trust for the tax. However, the amount recoverable from an entity that is simply a beneficiary is limited to benefits received by the beneficiary from the trust. Relief is also available in some cases for a contributor whose contribution to the trust is insignificant relative to other contributions made to the trust.	Jointly and severally, and solidarily, liable: paragraph 94(3)(*d*) Limit to amount recoverable - 94(7) Recovery limit - 94(8) Determination of fair market value - 94(9) Definitions - 94(10)
3. Where the NRT rules apply to a trust for a taxation year, how will the trust's tax liabilities be calculated?	A. Canadian rules apply to the trust as if the trust were resident in Canada throughout the year for the purpose of computing the trust's income.	s. 94(3)
	B. Explicit rule treats the trust as becoming resident in Canada, with resulting adjustment to cost amount of property under section 128.1.	s. 94(3)(*c*)
	C. Parts XII.2 and XIII do not apply to the trust. Explicit exemption from Part XIII tax on amounts distributed to the trust, although payer must still withhold.	s. 94(3)(*a*)(v) and (4)(*b*)
	D. Flow-through of income to resident and non-resident beneficiaries permitted, subject to special rules in the event that Canadian-source income is distributed to non-residents.	s. 104(7.01) - special rules

Definitions

ITA
94(1)

New subsection 94(1) of the Act defines a number of expressions that apply for the purpose of section 94.

"arm's length transfer"

A loan or transfer of property by an "entity" in respect of a trust will not be considered a "contribution" to the trust where the loan or transfer is an "arm's length transfer". In these circumstances, the transferor entity will not be considered to be a "contributor" to the trust. Accordingly, subsection 94(3) does not apply to a non-resident trust as a consequence only of an "arm's length transfer" in respect of the trust. (For more detail on the definitions "contribution", "contributor" and "entity" in subsection 94(1), see the commentary on those definitions.)

The definition "arm's length transfer" also is relevant in applying the rules in new paragraphs 94(2)(*a*) and (*c*). Under those rules, a loan or transfer of property made to an entity other than a particular trust may, in specified circumstances, result in a transfer of property being considered to have been made to the particular trust. (For more detail, see the commentary on new subsection 94(2).)

Under paragraphs (*a*) to (*c*) of the definition, an arm's length transfer includes, in general terms, an arm's length return on investment (conferred by the entity in which the investment is made), certain payments made by a corporation on a reduction of the paid up capital in respect of shares of a class of the corporation's capital stock, and an arm's length loan or transfer of property made in the ordinary course of business. A transfer that is an arm's length return on investment or reduction of paid up capital will not constitute an arm's length transfer, however, where the transfer is one described in new paragraph 94(2)(*g*), which is described in the commentary below.

Under paragraph (*d*) of the definition, an arm's length transfer includes a transfer to a trust by a "specified charity" (as defined in new subsection 94(1)) in respect of the trust that is made by the specified charity for the purpose of refunding in whole or in part a gift previously made to the specified charity entity by the trust. For more detail on the definition "specified charity", see the commentary on that definition.

In any other case, a loan or transfer of property by a transferor entity to another entity will generally be considered to be an "arm's length transfer" if two conditions described in paragraph (*e*) of the definition are met. First, it is reasonable to conclude that none of the reasons

for the transfer was to confer a benefit on the transferor, a descendant of the transferor or any person with whom the transferor or descendant does not deal at arm's length. Secondly, in general terms, the loan or transfer of property is an arm's length exchange or repayment, including a payment by the transferor to a trust (or to a corporation controlled by the trust or a partnership of which the trust is a majority interest partner) in respect of an arm's length loan made by the trust (or by that corporation or partnership) to the transferor.

The definition "arm's length transfer" generally applies to trust taxation years that begin after 2001. However, where a trust elects, by notifying the Minister in writing on or before its filing-due date for its taxation year that includes the day on which this Act is assented to, the definition "arm's length transfer" will be read without reference to a loan or transfer of property that is made before 2002 and identified in the election. This electing provision recognizes that the definition "arm's length transfer" in the new rules does not have an equivalent under existing subsection 94(1) of the Act. In particular, a non-resident trust now considered resident by reason of existing subsection 94(1) might not be described in new subsection 94(3) and would no longer be considered resident, which would result in the emigration rules in section 128.1 applying. The election, which is found in the coming-into-force provision of the amending legislation, effectively permits a trust to continue to be deemed resident.

"beneficiary"

Under the new definition "beneficiary" in subsection 94(1), a beneficiary of or under a trust includes:

- an entity beneficially interested in the trust, and

- an entity that has any right (whether immediate or future, whether absolute or contingent or whether conditional on or subject to the exercise of any discretion by any person or partnership) as a beneficiary under the trust to receive any of the income or capital of the trust either directly from the trust or indirectly through one or more entities (other than a corporation resident in Canada or a corporation a class of the shares of which is listed on a prescribed stock exchange).

For the purposes of the Act, the expression "beneficially interested" has the meaning assigned by subsection 248(25) of the Act.

"connected contributor"

The definition "connected contributor" is relevant to determining whether a beneficiary is, at a particular time, a "resident beneficiary" (as defined in new subsection 94(1)) under a non-resident trust. Under new paragraph 94(3)(*d*) of the Act, such a resident beneficiary can, to an extent, be liable for the trust's income tax. For more detail, see the commentary on subsections 94(3) and (7) to (10).

A connected contributor at a particular time is any entity, including an entity that has ceased to exist, that is a "contributor" (as defined in new subsection 94(1)) to the trust at that time, other than

- an individual who was resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including a trust or an individual who before that time was never non-resident), and

- an entity that is a contributor only because of one or more transactions that occurred at a "non-resident time" (as defined in new subsection 94(1)) of the entity.

For more detail on the definitions "contributor", "resident beneficiary" and "non-resident time" in subsection 94(1), see the commentary on those definitions.

In the context of the definition "connected contributor", reference should also be made to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94) and to new paragraphs 94(2)(*n*) to (*r*) and subsections 94(2.1) to (2.3) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94). Reference should also be made to new subsection 94(11), which applies where a contributor becomes resident in Canada within 60 months after making a contribution to a trust.

"contribution"

Where a "contribution" is made at or before a particular time to a non-resident trust by an entity, that entity will be considered to be a "contributor" at the particular time and, in certain cases, will be jointly and severally and solidarily liable under subsection 94(3) for the trust's income taxes. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.) For more detail on subsection 94(3), see the commentary on that subsection.

Under paragraph (*a*) of the definition, a "contribution" to a trust by a particular entity means a loan or transfer of property (in this commentary referred to as a "transfer") by the entity to the trust (other than an "arm's length transfer", as defined in new subsection 94(1)). For more detail, see the commentary on that definition.

Under paragraphs (*b*) and (*c*) of the definition "contribution", a contribution also is made where

- a particular entity makes a particular transfer (other than an "arm's length transfer") as part of a series of transactions or events that includes another transfer, to the trust, by another entity; or

- a particular entity becomes obligated to make a particular transfer (other than an "arm's length transfer") as part of a series of transactions or events that includes another transfer, to the trust, by another entity.

In these circumstances, the other transfer is considered to be a contribution to the trust by the particular entity to the extent that the other transfer can reasonably be considered to have been enabled by the particular transfer or the particular entity's obligation to make the particular transfer, as the case may be. In either case, a contribution is considered to be made at the time of the other transfer.

Under new subsection 94(2), there are a number of rules that have the effect of applying the definition "contribution" more broadly than would otherwise be the case. See the commentary on new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94) and paragraphs 94(2)(*n*) to (*r*) and subsections 94(2.1) to (2.3) (which generally

extend the circumstances in which a contribution is considered to be made for the purposes of section 94).

The definition "contribution" applies to taxation years of trusts that begin after 2001, whether a relevant loan or transfer of property occurred before that time or not. However, in order to provide for transition between the existing and new rules, a "contribution" does not include:

- a payment made before 2002 to a trust (or to a particular entity that, at the time the amount became payable to the particular entity, was a corporation controlled by the trust or was a partnership of which the trust was a majority interest partner) in satisfaction of any amount payable to the trust or the particular entity, or

- a payment made before 2005 to a trust or to a particular entity in accordance with repayment terms agreed to before June 23, 2000 in respect of a loan made by the trust (or by a particular entity that, at the time the loan was made by the particular entity, was a corporation controlled by the trust or was a partnership of which the trust was a majority interest partner).

"contributor"

A "contributor" to a trust at any time means an "entity" (as defined in new subsection 94(1)), including an entity that has ceased to exist, that at or before that time has made a "contribution" (as defined in new subsection 94(1)) to the trust. The definition "contributor" is significant primarily for the purposes of the definitions "resident contributor" and "connected contributor" in new subsection 94(1). For more detail, see the commentary on those definitions.

Reference should be made in this context to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94) and paragraphs 94(2)(*n*) to (*r*) and subsections 94(2.1) to (2.3) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94).

"entity"

The expression "entity" is defined to include an association, a corporation, a fund, an individual, a joint venture, an organization, a partnership, a syndicate and, for greater certainty, a trust.

"exempt foreign trust"

An "exempt foreign trust" includes a number of different types of non-resident trusts that are exempt from the application of new subsection 94(3). The expression refers to the following types of non-resident trusts:

- (*a*) a non-resident trust the current income (determined with reference to amended subsection 108(3)) or capital from which can be provided only to one or more physically or mentally infirm dependent individuals, provided that these individuals are non-resident and that any property settled on the trust could reasonably be considered, at the time it was settled, to be necessary for the maintenance of those individuals;

- (*b*) a non-resident trust created after the breakdown of a marriage or common-law partnership of two individuals, the current income (determined with reference to amended subsection 108(3)) or capital from which can be provided only to non-resident children of one of the individuals, if the children are under 21 years of age (or under 31 years of age and enrolled in a specified educational institution) and each "contribution" to the trust (as defined in subsection 94(1)) was to provide for the maintenance of those children;

- (*c*) certain non-resident trusts that own or administer a university described in paragraph (*f*) of the definition "total charitable gifts" in subsection 118.1(1) and that could qualify under that definition as a recipient permitted for the purposes of the tax credit for charitable gifts;

- (*d*) certain non-resident trusts established exclusively for charitable purposes (as those purposes are defined in the laws of Canada);

- (*e*) a non-resident trust that is governed by an employee profit sharing plan (as defined in subsection 248(1)), by a retirement

compensation arrangement (as defined in subsection 248(1), or by a foreign retirement arrangement (as defined in subsection 248(1));

- (*f*) a non-resident trust that is governed by an employee benefit plan (as defined in subsection 248(1)) or that is a trust described in paragraph (*a*.1) of the definition trust in subsection 108(1), and that meets the following two conditions:

  (i) the plan or trust is maintained primarily for the benefit of non-resident individuals in respect of services rendered outside of Canada, and

  (ii) if contributions are made in respect of services rendered by an employee while resident in Canada, certain conditions are met that are intended to ensure that the provision of benefits is limited to employees who are cross-border commuters and short-term residents;

- (*g*) a non-resident trust that at all times after it was created has been

  (i) resident in a country (other than Canada) under the laws of which an income tax is imposed,

  (ii) exempt under the laws referred to in subparagraph (i) from the payment of income tax to the government of that country,

  (iii) operated exclusively for the purpose of administering or providing benefits under, one or more superannuation, pension or retirement funds or any funds or plans established to provide employee benefits, and

  (iv) maintained for the benefit of persons all or substantially all of whom are non-resident individuals;

- (*h*) a non-resident trust that is described in paragraph (*c*) of the definition "exempt trust" in subsection 233.2(1) (i.e., certain foreign unit trusts that are dealt with under the foreign investment entity rules in new sections 94.1 and 94.2), unless the trust qualifies to elect to remain subject to the rules in section 94 and not the rules in sections 94.1 and 94.2. Where the trust so qualifies and makes the election, the election is deemed (under the

coming-into-force provision of the amending legislation) to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister on or before the trust's filing-due date for the taxation year of the trust that includes the day on which the amending legislation is assented to; or

- (*i*) a prescribed trust or prescribed class of trusts. (At the present time, it is not anticipated that any trust or class of trusts will be prescribed for this purpose.)

"non-resident time"

The definition "non-resident time" is relevant in determining whether a contributor to a trust is a "connected contributor" (including by reference to new subsection 94(11)) and whether the "look-through" rule in paragraph 94(2)(*m*) applies in determining whether an entity has made a contribution (i.e., is a contributor).

The "non-resident time" of an entity in respect of a particular time means a time (referred to in this commentary as the "contribution time") at which the entity made a contribution to a trust, that is before the particular time and at which the entity was non-resident, provided that the entity was non-resident (or not in existence) throughout a specified period.

As indicated into the coming-into-force provision for new section 94 of the Act, where the contribution time occurs before June 23, 2000, the specified period is the period that begins 18 months before the end of the trust's taxation year that includes the contribution time and ends at the earliest of

- 60 months after the contribution time;
- where the entity is an individual, the date of the individual's death; and
- subject to subsection 94(11), the particular time.

Where the contribution time occurs after June 22, 2000 and the trust arose as a consequence of the death of an individual, the specified period is the period that begins 18 months before the contribution time and ends at the earliest of

- 60 months after the contribution time;

- where the entity is an individual, the date of the individual's death; and

- subject to subsection 94(11), the particular time.

Where the contribution time occurs after June 22, 2000 and the trust did not arise as a consequence of the death of an individual, the specified period is the period that begins 60 months before the contribution time and ends at the earliest of

- 60 months after the contribution time;

- where the entity is an individual, the date of the individual's death; and

- subject to subsection 94(11), the particular time.

The measurement of the specified period by reference to any particular time is to ensure that the contributing entity and the trust may, subject to new subsection 94(11), treat the contribution time as a "non-resident time" for the purposes of applying subsection 94(3) at the end of any particular trust taxation year if at the end of that particular year the contributor still has not become resident in Canada within the 60-month period after the contribution time.

However, as detailed in the commentary on new subsection 94(11), new subsection 94(11) ensures that such a contributor will, for the purposes of the definition "connected contributor", be considered to have made the contribution at a time other than a "non-resident time" if the contributor becomes resident in Canada within the 60-month period after the contribution time. As a result, at the end of each of the trust's taxation years following the contribution, there would be a non-resident beneficiary under the trust and subsection 94(3) would apply in respect of those years.

Amended subparagraph 152(4)(*b*)(vi) of the Act ensures that a reassessment of a taxpayer arising out of the application of subsection 94(11) may be undertaken by the Canada Customs and Revenue Agency within 3 years after the end of the taxpayer's normal reassessment period for the taxpayer's relevant taxation year.

For more detail on new subsection 94(11) and amended subparagraph 152(4)(*b*)(vi), see the commentary on those provisions.

"resident beneficiary"

Under new subsection 94(3), a particular trust is generally treated as resident in Canada for a particular taxation year if there is a "resident beneficiary" under the particular trust at the end of the particular year. Under new paragraph 94(3)(*d*), each "resident beneficiary" can be jointly and severally and solidarily liable with the particular trust for the particular trust's income tax liabilities under the Act for the particular year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.) For more detail, see the commentary on subsection 94(3).

A "resident beneficiary" at a particular time under a trust is an entity (other than an entity that is at that time a "specified charity" or a "testamentary beneficiary" in respect of the trust) that, at that time, is a beneficiary under the trust, if, at that time,

- the entity is resident in Canada; and

- there is a "connected contributor" to the trust.

The expressions "connected contributor", "specified charity" and "testamentary beneficiary" are defined in new subsection 94(1). For further details, see the commentary on those definitions.

"resident contributor"

Under new subsection 94(3), a trust is generally treated as resident in Canada for a particular taxation year if there is a "resident contributor" to the trust at the end of the particular year. Under new paragraph 94(3)(*d*), a "resident contributor" can be jointly and severally and solidarily liable with the trust for the trust's income tax liabilities under the Act for the particular year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

A "resident contributor" at any time means an entity that is, at that time, resident in Canada and a "contributor" (as defined in new subsection 94(1)) to the trust. However, an exemption from treatment as a resident contributor is provided for a contributor who is:

- an individual who was resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including a trust or an individual who before that time was never non-resident); and

- an individual, where the trust is an *inter vivos* trust that was created before 1960 by a person who was non-resident when the trust was created and the individual made no contribution after 1959 to the trust.

In the context of this definition, reference should also be made to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94) and to new paragraphs 94(2)(*n*) to (*r*) and subsections 94(2.1) to (2.3) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94).

"specified charity"

The expression "specified charity" is used in the definitions "arm's length transfer" and "resident beneficiary" in new subsection 94(1). An arm's length transfer includes a refund, from a specified charity in respect of a trust to the trust, of a gift previously made by the trust to the charity. A resident beneficiary under a trust does not include a specified charity. For more detail, see the commentary on those definitions.

A specified charity in respect of a trust at any particular time means a person (in this commentary referred to as a "charity") that at that time is described in any of paragraphs (*a*) to (*e*) and (*g*.1) of the definition "total charitable gifts" in subsection 118.1(1). However, a specified charity does not include:

- a charity that does not, at a particular time, deal at arm's length with a "specified entity" in respect of the trust; or

- a charity that did not, at any "specified prior time" in respect of the charity, deal at arm's length with a specified entity in respect of the trust.

For this purpose, a "specified prior time" in respect of a charity is defined in paragraph (*c*) of the definition "specified charity" as meaning any time, before the particular time, at which

- an amount was payable to the charity as a beneficiary under the trust,

- an amount was received by the charity on the disposition of the charity's interest in the trust, or

- a benefit was received or enjoyed by the charity from or under the trust.

Paragraph (*d*) of the definition "specified charity" defines a "specified entity" in respect of a trust at any time to mean

- an entity that is at that time beneficially interested in the trust, a contributor to the trust, a person related to a contributor to the trust, a trustee of the trust, an entity that could reasonably be considered to have influence over the operation of the trust or the enforcement of its terms, or an entity that could reasonably be considered to have influence over the selection or appointment of an entity referred to above, or

- any group at least one of the members of which is described in the bullet immediately above.

"testamentary beneficiary"

The expression "testamentary beneficiary" is used in the definition "resident beneficiary" in new subsection 94(1). A resident beneficiary under a trust does not include a testamentary beneficiary.

A testamentary beneficiary in respect of a trust at a particular time means an entity that is a beneficiary under the trust solely because of a right, to receive income or capital of the trust, that arises only on or after the death after that time of a specified individual. For this purpose a specified individual is an individual who is, at that time,

alive and is a contributor to the trust, an individual related to a contributor to the trust or an individual who would have been related to a contributor to the trust if every individual who was alive before that time were alive at that time.

"treasury interest"

A "treasury interest" in a trust means an interest of a beneficiary under the trust that was issued by the trust for consideration.

The expression "treasury interest" is relevant to the application of paragraphs 94(2)(*q*) and (*r*) of the Act, which provide rules for determining whether the acquisition or transfer of such an interest is considered to be a contribution to the trust. For more details, see the commentary on new subsection 94(2).

Rules of Application

ITA
94(2)

New subsection 94(2) of the Act sets out a number of rules for use in applying section 94. These rules are primarily relevant for the purposes of determining whether a transaction constitutes a "contribution" (as defined in subsection 94(1)) of property to a trust. These rules are also relevant for the purposes of subsections 94(7) to (10) and the amended reporting rules in subsections 162(10.1) and 163(2.4) and section 233.2.

Paragraphs 94(2)(*n*) to (*r*) provide rules that generally extend the circumstances in which a contribution is understood to occur. Paragraphs 94(2)(*a*) to (*m*) provide rules that deem certain loans or transfers, the granting of options and the provision of services to be transfers of property an entity. A deemed transfer will be considered to be a "contribution" to a trust if the transfer falls within the criteria of that definition. In this regard, it should be noted that a contribution does not include a transfer that is an "arm's length transfer" (as defined in new subsection 94(1)).

The rules in subsection 94(2) generally apply to taxation years of trusts that begin after 2001, but in some cases relief is provided with regard to transactions or events that occur before June 23, 2000. In

addition, a trust created in 2001 may elect in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Paragraph 94(2)(*a*) of the Act generally applies to indirect loans or transfers of property to a trust through transfers to other entities. Paragraph (*a*) deems, except where paragraph 94(2)(*c*) applies, a transfer of property (other than an "arm's length transfer", as defined in new subsection 94(1)) to be a direct transfer to a trust if the property is transferred from one entity to another and, as a result of the transfer, the fair market value of the property of the trust increases or the liabilities of the trust decrease. Where paragraph (*a*) applies, paragraph 94(2)(*b*) deems the fair market value of property deemed transferred under paragraph 94(2)(*a*) to be the total of all amounts each of which is the absolute value of an increase in the fair market value of the trust property or a decrease in the liabilities of the trust because of the transfer.

Paragraph 94(2)(*c*) also applies to indirect loans or transfers of property to a trust. Paragraph (*c*) deems a transfer or loan of property (other than an "arm's length transfer") from an entity (in this commentary, "the transferor") to another entity to be a direct transfer to a trust where the trust holds property the fair market value of which is derived from property held by the other entity and it is reasonable to conclude that one of the reasons for the transfer was to confer a benefit on the transferor, a descendant of the transferor or any person with whom the transferor or descendant does not deal at arm's length. Paragraph 94(2)(*d*) deems the fair market value of property deemed transferred under paragraph 94(2)(*c*) to be the fair market value of the property actually transferred.

Paragraph 94(2)(*e*) deems an entity that provides a guarantee or other financial assistance to another entity to have transferred property to that other entity. Under paragraph 94(2)(*i*), the fair market value of the property deemed to have been transferred is deemed to be the fair market value of the assistance.

Paragraph 94(2)(*f*) applies where any service (other than exempt service) is rendered after June 22, 2000 by an entity to, for or on behalf of another entity. In these circumstances, the entity rendering

the service is deemed to have transferred property to the other entity. For this purpose, an exempt service generally means a service:

- where the other entity is a trust, that relates to the administration of the trust, or

- that is performed by the entity as an employee or agent of the other entity and is carried out on an arm's length basis.

Under paragraph 94(2)(*i*), the fair market value of the property deemed under paragraph 94(2)(*f*) to have been transferred is deemed to be equal to the fair market value of the services rendered.

For greater certainty, paragraph 94(2)(*g*) provides that a corporation is considered to transfer shares that it issues. Similar rules, also contained in paragraph 94(2)(*g*), apply to interests in a trust, partnership or other entity, as well as to debt issued to an entity by another entity.

Paragraph 94(2)(*h*) deems an entity that, after June 22, 2000, grants to another entity a right to acquire or to be loaned property to have transferred property to that other entity. Under paragraph 94(2)(*i*), the fair market value of the property deemed to have been transferred under paragraph 94(2)(*h*) is deemed to be equal to the fair market value of the right.

As noted above, paragraph 94(2)(*i*) is relevant to determining the fair market value of property deemed under paragraphs 94(2)(*e*), (*f*) or (*h*) to have been transferred.

Paragraph 94(2)(*j*) deems an entity to have become obligated at a particular time to transfer property to another entity where the entity becomes obligated to do an act (e.g., the rendering of a service) that would constitute the transfer of a property to another entity if the act were to occur. This rule is generally relevant for the purposes of paragraph (*c*) of the definition "contribution" in subsection 94(1).

Paragraph 94(2)(*k*) applies if an entity acquires property as a consequence of the death of an individual. In these circumstances, paragraph 94(2)(*k*) deems the individual to have transferred the property to the entity immediately before the individual's death.

Paragraph 94(2)(*l*) applies where a particular entity loans or transfers property to another entity at the direction or with the acquiescence of a third-party entity. In these circumstances, if it reasonable to conclude that one of the reasons for the transfer is to enable the third-party entity (or any entity that does not deal at arm's length with the third-party entity) to avoid or minimize liability under paragraph 94(3)(*d*) in respect of any trust, the transfer is deemed to be a transfer made jointly by the particular entity and the third-party entity.

Paragraph 94(2)(*m*) also applies where a particular entity loans or transfers property to another entity at the direction or with the acquiescence of a third-party entity. In these circumstances, the transfer is deemed to be a transfer made jointly by the particular entity and the third-party entity if

- the transfer is made at a time other than a "non-resident time" (as defined in new subsection 94(1)) of the third-party entity, and

- either

    - the particular entity is at the time of the transfer a controlled foreign affiliate of the third-party entity (or would be a controlled foreign affiliate of the third-party entity if the third-party entity were resident in Canada), or

    - it is reasonable to conclude that the transfer was made in contemplation of the particular entity becoming after the time of the transfer a controlled foreign affiliate of the third-party entity (or a controlled foreign affiliate of the third-party entity if the third-party entity were resident in Canada).

The expression "controlled foreign affiliate" is defined in subsection 248(1) of the Act as having the meaning given in subsection 95(1).

Paragraph 94(2)(*n*) applies where a particular trust makes a contribution to another trust. If this is the case, the contribution is deemed to have been made jointly by the particular trust and each other entity that is a contributor to the particular trust.

Paragraph 94(2)(*o*) applies where a partnership makes a contribution to a trust. Where this is the case, the contribution is deemed to have

been made jointly by the partnership and by each entity that is a partnership member (other than a limited partner) at the time of the contribution. However, a partnership and a limited partner of the partnership may both contribute to a trust where the contribution is a transfer made by a partnership in circumstances described in paragraph 94(2)(*l*).

Paragraph 94(2)(*p*) provides, subject to subsection 94(9), that the amount of a contribution to a trust at the time it was made is deemed to be the fair market value at that time of the property that was the subject of the contribution. The rule is useful for the purposes of new subsections 94(7) and (8), as well as the reporting penalty provisions in amended subsections 162(10.1) and 163(2.4). The rule is relevant because a contribution is defined by reference to a loan or transfer, rather than by reference to the property that was the subject of the transfer or loan.

Paragraphs 94(2)(*q*) and (*r*) apply to contributions involving a "treasury interest" (as defined in new subsection 94(1)) in a trust (or a right to acquire such an interest). A treasury interest in a trust means an interest as a beneficiary under the trust that was issued by the trust for consideration. Paragraph 94(2)(*q*) deems an entity to have made a contribution to a trust at a particular time where the entity acquires a treasury interest at that time from another entity (other than the issuing trust). The amount of the contribution is deemed to be the fair market value at that time of the treasury interest.

Paragraph 94(2)(*r*) generally applies where an entity has made a contribution to a trust because of acquiring a treasury interest (or a right to a treasury interest) and at a later time transfers the interest (or right) to another entity (other than the issuing trust) for arm's length consideration. In these circumstances, the entity is deemed, for the purpose of applying section 94 at any time after the later time, not to have made the contribution.

The examples below illustrate the operation of subsection 94(2) and the definition "contribution" in subsection 94(1).

Example 1

Donald is a long-term resident of Canada. In 2002, Donald pays higher than fair market value consideration for a property

acquired from a corporation. A non-resident trust holds shares in the corporation. The fair market value of those shares increases because of the transaction.

Results

1. *Under paragraph 94(2)(a), Donald is considered to have transferred property to the trust in these circumstances. The exception for arm's length transfers does not apply.*

2. *As a consequence, Donald is considered to have made a contribution to the trust, which results in Donald being a contributor and a resident contributor to the trust.*

Example 2

1. *Lucie, a long-term resident of Canada, transfers property to Canco on condition that Canco direct Canco's wholly-owned foreign subsidiary (Foreignco-1) to transfer properties to another corporation (Foreignco-2) for consideration that is less than fair market value.*

2. *Shares of the capital stock of Foreignco-2 are held by a non-resident trust.*

3. *The fair market value of the Foreignco-2 shares increases as a result of the increase in the fair market value of the property owned by Foreignco-2.*

Results

1. *The transfers to Canco and to Foreignco-2 are part of the same series of transactions.*

2. *Because of paragraph 94(2)(a), the transfer to Foreignco-2 is considered to be a transfer by Foreignco-1 to the trust. Because of paragraph 94(2)(m), the transfer by Foreignco-1 to the trust is considered to be jointly made by Foreignco-1 and Canco. (This would also be the result under paragraph 94(2)(l), if it was intended to avoid or minimize a liability under paragraph 94(3)(d).) The exception for arm's length transfers does not apply.*

3. *Canco is considered to have made a contribution to the non-resident trust because of paragraph (a) of the definition "contribution" in new subsection 94(1). Lucie is considered to have made a contribution to the trust under paragraph (b) of that definition. Both Lucie and Canco are therefore contributors and resident contributors to the trust.*

4. *Foreignco-1 is also a "contributor" to the trust, but this does not have any practical consequences because Foreignco-1 is non-resident.*

Deemed Contributor

ITA
94(2.1) to (2.3)

Subsections 94(2.1) to (2.3) of the Act provide a set of related anti-avoidance rules that apply where it is reasonable to conclude that one of the reasons for a loan or transfer of property from a trust (the "original trust"), that is deemed under paragraph 94(3)(*a*) to be resident in Canada, to another trust (the "transferee trust") is to avoid or minimize the liability of any entity under the Act.

Where such a loan or transfer is made at a particular time, an entity that is at that time a contributor to the original trust is deemed, under subsection 94(2.2), to be a contributor to the transferee trust and a connected contributor to the transferee trust (if at that time the entity is also a connected contributor to the original trust). For more detail on the definitions "contributor" and "connected contributor", see the commentary on those definitions.

Subsection 94(2.3) provides that, in applying paragraph 94(3)(*d*) to determine the liability of an entity deemed under subsection 94(2.2) to be a contributor or connected contributor of a transferee trust, the Act shall be read without reference to the recovery limit rules in subsection 94(7). Subsection 94(2.3) provides an exception to the general rule that the liability of a "resident contributor" is limited by that contributor's recovery limit, as determined by reference to subsections 94(7) to (10). For more detail on the definition "resident contributor" or subsections 94(3) and (7) to (10), see the commentary on those provisions.

Liabilities of Non-resident Trusts and Others

ITA
94(3)

New subsection 94(3) of the Act applies to a non-resident trust (other than an "exempt foreign trust", as defined in subsection 94(1)) for a taxation year where, at the end of the year, there is a "resident contributor" to the trust or a "resident beneficiary" under the trust. All of these expressions are explained in detail in the commentary on new subsection 94(1).

Where subsection 94(3) applies to a non-resident trust for a taxation year, the trust is deemed to be resident in Canada throughout the year for the purposes specified in the subsection. Except to the extent otherwise provided by subsection 94(4), a trust is deemed to be resident in Canada for a taxation year under subsection 94(3):

- for the purposes of applying sections 2 and 115, computing the trust's income for the year and computing the trust's liability for tax under Part I – with the result that the trust is subject to tax under that Part on its world-wide income for the year (Note: These trusts are viewed as resident in Canada for the purposes of tax treaties whether they are also considered to be resident in another country or not. However, subsection 94(3) is structured so that there is no tax arising under the Act for a trust subject to subsection 94(3) in the event that the trust earns only foreign-source income and makes full current distributions of the income to non-resident beneficiaries.);

- for the purpose of applying of subsections 94(5) and (5.1) – with the result that, as contemplated by those subsections, the tax consequences under subsection 128.1(4) for a trust that ceases to be resident in Canada apply to the trust (See also the note on paragraph 94(3)(*c*), below.);

- for the purpose of applying clause 53(2)(*h*)(i.1)(*B*) – with the result that the adjusted cost base to a beneficiary of the beneficiary's interest in a trust to which this clause applies is computed in the same way as for interests in trusts resident in Canada;

- for the purpose of applying the definition "non-resident entity" in subsection 94.1(1) – with the result that a beneficiary's interest in the trust is not treated as an interest of a beneficiary in a foreign investment entity for the purposes of new sections 94.1 and 94.2;

- for the purposes of applying subsections 104(13.1) to (29) and 107(5) – with the result that the tax treatment of beneficiaries under the trust accords with the tax treatment available to beneficiaries under trusts that are resident in Canada;

- for the purpose of applying the definition "exempt property" in subsection 108(1) – with the result that (absent a provision in a tax treaty) the property of the trust is not an "exempt property" and is subject to the "21-year deemed realization" rule for trusts; (This rule is set out in subsections 104(4) to (5.2) of the Act and its purpose is to prevent the use of trusts to defer indefinitely the recognition for tax purposes of gains accruing on capital properties, resource properties and land inventories. These subsections generally treat such properties as having been disposed of and reacquired by trusts every 21 years at the properties' fair market value.);

- for the purposes of applying sections 233.3 and 233.4 – with the result that the trust is required to file information returns under sections 233.3 (information return on foreign property holdings the total cost of which exceeds $100,000) and 233.4 (information return on foreign affiliates);

- for the purpose of determining the liability of the trust for tax under Part XIII – with the result that the trust is exempt from Part XIII tax on amounts paid or credited to it; and

- for the purpose of determining the rights and obligations of the trust under sections 150 to 180 – with the result that various administrative provisions in the Act apply in the same way as to other trusts resident in Canada. (These provisions include those with regard to the filing of returns, assessments, tax payments, arrears interest, refund interest, instalment interest, penalties, refunds and appeals.)

Paragraph 94(3)(*b*) provides that a trust that is subject to subsection 94(3) is entitled to claim foreign tax credits against its Canadian

income tax in accordance with the rules in section 126, except with regard to any taxable income earned in Canada (as would otherwise be determined under subsection 115(1)).

Paragraph 94(3)(*c*) clarifies that a non-resident trust that becomes subject to subsection 94(3) for a particular taxation year, after

- not being subject to either new subsection 94(3) or existing paragraph 94(1)(*c*) for the preceding year, or

- having been deemed by new subsections 94(5) or (5.1) to have ceased to be resident in Canada in the preceding year,

is deemed to become resident in Canada at the beginning of the particular year. As a result, the cost amount of each of the properties (other than taxable Canadian properties) held by the trust at the beginning of the particular year is deemed by subsection 128.1(1) to be the fair market value of the property at the beginning of the particular year. Note, in this regard, that paragraph 94(3)(*c*) complements the rule in subsection 94(6) in the case where a non-resident trust ceases to be an "exempt foreign trust" (as defined in subsection 94(1)). In this case, subsection 94(6) establishes the beginning of a new "stub" taxation year to which subsection 94(3) may apply. If subsection 94(3) does apply for that "stub" year, subsection 128.1(1) would apply with regard to the properties (other than taxable Canadian properties) held by the trust at the beginning of that "stub" year.

Paragraph 94(3)(*d*) imposes liabilities for a taxation year on persons who are "resident contributors" or "resident beneficiaries". Where subsection 94(3) applies to a trust for a taxation year, each of these persons is jointly and severally and solidarily liable with the trust in respect of the trust's obligations under sections 150 to 180. Typically, the most significant obligation in this context is the obligation to pay tax instalments pursuant to section 156. However, the extent of the liability imposed by paragraph 94(3)(*d*) is limited by new subsection 94(7). For more detail, see the commentary on subsections 94(7) to (10).

The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.

Note that subsection 94(3) does not result in the creation of any obligations for a trust that is subject to subsection 94(3) to withhold tax on distributions to non-resident beneficiaries under Part XIII or to pay any tax under Part XII.2. As noted above, one of the effects of subsection 94(3) is that the trust is not liable in connection with distributions of Canadian-source income to the non-resident beneficiaries. However, the rules in new subsection 104(7.01) are designed so that there will be a reasonable level of Part I tax in respect of Canadian-source income received by the trust in the event the trust also distributes income to non-resident beneficiaries. For more detail, see the commentary on subsection 104(7.01).

Excluded Provisions

ITA
94(4)

New subsection 94(4) of the Act provides that the rules in subsection 94(3) treating non-resident trusts as resident in Canada do not apply for certain limited purposes:

- the definition "exempt foreign trust" – thus ensuring that there is no circularity due to fact that the definition "exempt foreign trust" is used in subsection 94(3);

- subsection 73(1) and paragraph 107.4(1)(*c*) (other than subparagraph 107.4(1)(*c*)(*i*)) and subparagraph (*f*)(ii) of the definition "disposition" in subsection 248(1) – thus ensuring that proposed rules allowing in some cases for a rollover of property on transfers to a trust generally do not apply to transfers to a trust deemed to be resident in Canada by subsection 94(3); and

- paragraph (*a*) of the definition "mutual fund trust" in subsection 132(6) – a reference that makes it clear that a trust deemed to be resident in Canada by subsection 94(3) will not be treated as a mutual fund trust for any purpose.

Furthermore, except as otherwise permitted in writing by the Minister of National Revenue, subsection 94(3) does not relieve a payer of Canadian-source income from the obligation to withhold amounts under section 215 in connection with amounts paid to a trust deemed to be resident in Canada by subsection 94(3). This is so even though

such a trust is not liable for Part XIII tax on amounts paid or credited to it, because of the application of subparagraph 94(3)(*a*)(v). The trust would be expected to apply for a refund of such tax, which would be given except to the extent that there are any outstanding liabilities of the trust with regard to Part I tax.

Deemed Cessation of Residence

ITA
94(5)

New subsection 94(5) of the Act deems a trust to have ceased to be resident in Canada at the earliest time in a specified period at which there is neither a "resident contributor" to the trust nor a "resident beneficiary" under the trust. For this purpose, the specified period is the period that would (if the Act were read without reference to subsections 94(5) and 128.1(4)) be a taxation year of the trust

- that immediately follows a taxation year of the trust throughout which it was resident in Canada,

- at the beginning of which there was either a resident contributor to the trust or a resident beneficiary under the trust, and

- at the end of which the trust is non-resident.

For more detail on the expressions "resident contributor" and "resident beneficiary", as defined in new subsection 94(1), see the commentary on those provisions.

Where subsection 94(5) applies, the cessation of residence in Canada of a trust results in the application of subsection 128.1(4). Under that subsection, a taxation year of the trust is deemed to have ended immediately before the earliest time in the specified period described above. At that deemed taxation year end, the criteria in subsection 94(3) are satisfied. Accordingly, the trust will be subject to tax under Part I on its world-wide income for that year because it is considered under subsection 94(3) to be resident in Canada throughout that year. Under new paragraph 94(3)(*d*), each "resident beneficiary" or "resident contributor" at the time of that deemed taxation year end can be jointly and severally and solidarily liable with the trust for the trust's income tax liabilities under the Act for that year. (The

expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Deemed Cessation of Residence

ITA
94(5.1)

New subsection 94(5.1) of the Act deems a trust to have ceased to be resident in Canada at the earliest time in a specified period at which there is no "resident contributor" (as defined in subsection 94(1)) to the trust. For this purpose, the specified period is the period that would (if the Act were read without reference to subsections 94(5.1) and 128.1(4)) be a taxation year of the trust

- that immediately follows a taxation year of the trust throughout which it was resident in Canada,

- at the beginning of which there was a resident contributor to the trust, and

- at the end of which the trust is non-resident or would be non-resident if the Act were read without reference to section 94.

For more detail on the expression "resident contributor", see the commentary on that definition.

Where subsection 94(5.1) applies, the cessation of residence in Canada of a trust results in the application of subsection 128.1(4). Under that subsection, a taxation year of the trust is deemed to have ended immediately before the earliest time in the specified period described above. At the time of that deemed taxation year end, the criteria in subsection 94(3) are satisfied. Accordingly, the trust will be subject to tax under Part I on its world-wide income for that year because it is considered under subsection 94(3) to be resident in Canada throughout that year. Under new paragraph 94(3)(*d*), each "resident beneficiary" or "resident contributor" at the time of that deemed taxation year end will be jointly and severally and solidarily liable with the trust for the trust's income tax liabilities under the Act for that year. (The expression "solidarily liable" is added to ensure

that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Subsection 94(5.1) applies without regard to the existence of a "resident beneficiary" (as defined in new subsection 94(1)) under the trust at the time the last resident contributor ceases to reside in Canada. Accordingly, notwithstanding the deemed cessation of residence under subsection 94(5.1) for a particular taxation year of the trust, if there is a resident beneficiary under the trust at the end of the immediately following year (or of any subsequent year) the trust will be deemed resident under subsection 94(3).

Becoming or Ceasing to be an Exempt Foreign Trust

ITA
94(6)

New subsection 94(6) of the Act generally provides that, if a trust becomes or ceases to be an "exempt foreign trust" (as defined in new subsection 94(1)) at any time, the trust's taxation year is deemed to have ended immediately before that time, a new "stub" taxation year is deemed to have begun at that time and the trust is deemed not to have established a fiscal period before that time. However, subsection 94(6) does not apply where a trust ceases to be an exempt foreign trust because it becomes resident in Canada.

Subsection 94(3) may apply in respect of the later "stub" taxation year of the trust if the criteria set out in that subsection are satisfied at the end of that year. Where this is the case, the trust would be subject to tax under Part I on its world-wide income for that later "stub" year because it would be considered under subsection 94(3) to be resident in Canada for that year.

Limit to Amount Recoverable

ITA
94(7) to (9)

New subsection 94(7) of the Act allows for a limitation of the amount that may be recovered from an entity that would otherwise be jointly, severally and solidarily liable for the entire amount of a trust's tax obligations under the Act. Subsection 94(7) applies to an

entity in respect of a particular taxation year of the trust where three conditions are satisfied.

The first condition is satisfied in respect of a particular taxation year of the trust:

- where, under subparagraph 94(7)(*a*)(i), the person is jointly and severally and solidarily liable with the trust only because the person was a "resident beneficiary" (as defined in new subsection 94(1)) under the trust at the end of the particular year, or

- where, under subparagraph 94(7)(*a*)(ii), at the end of the particular year, the total amount (determined with reference to paragraph 94(2)(*b*), (*d*), (*i*) and (*p*) and subsection 94(9)) of contributions made to the trust by the entity (or by another entity not dealing at arm's length with the entity) is not more than the greater of $10,000 and 10% of the total amount of all contributions to the trust.

The second condition, under paragraph 94(7)(*b*), requires that the entity have filed on a timely basis all information returns required to be filed by the entity in respect of the trust under section 233.2 (or on any later day that is acceptable to the Minister of National Revenue). However, the second condition need not be satisfied if the first condition is satisfied because the total determined under subparagraph 94(7)(*a*)(ii) (in respect of the entity and all entities not dealing at arm's length with it) is $10,000 or less.

The third condition, under paragraph 94(7)(*c*), is satisfied in respect of an entity and a particular taxation year of the trust where it is reasonable to conclude that each transaction or event that occurred before the end of the particular year at the direction of, or with the acquiescence of, the entity satisfied the following conditions:

- none of the purposes of the transaction or event was to enable the entity to avoid or minimize any liability under paragraph 94(3)(*d*) in respect of the trust, and

- the transaction or event was not part of a series of transactions or events any of the purposes of which was to enable the entity to avoid or minimize any liability under paragraph 94(3)(*d*) in respect of the trust.

There are a number of transactions or events, or series of transactions or events, that may result in a failure to satisfy the third condition (e.g., an artificial dilution of an entity's relative contribution to the trust (i.e., below the 10% level); or corporate distributions that have the effect of avoiding or minimizing the impact of the three-year rule described in subsection 94(9)).

Reference should be made in this context to the definition "contribution" in subsection 94(1), as well as to related rules in subsection 94(2).

Where subsection 94(7) applies to an entity in respect of a taxation year of a trust, the amount recoverable at any time from the entity in respect of the year is limited to the person's "recovery limit", determined under subsection 94(8), in respect of the trust and the year.

Under subsection 94(8), the amount of the recovery limit that applies to a particular entity at any particular time is calculated as follows:

- ADD amounts payable (i.e., amounts paid and amounts the payment of which is enforceable against the trust) at or before the particular time by the trust to the particular entity (or an entity that is, at the particular time, a "specified party", as defined in new subsection 94(10), in respect of the particular entity) in respect of the beneficial interest of the particular entity (or that specified party) under the trust;

- ADD previous proceeds from the disposition of the beneficial interest of the particular entity (or an entity that was, at the time the proceeds became receivable, a "specified party" in respect of the particular entity) in the trust, not otherwise taken into account above;

- ADD the fair market value of benefits received or enjoyed under the trust by the particular entity (or an entity that was, at the time the benefit was received or enjoyed, a "specified party" in respect of the particular entity), not otherwise taken into account above;

- ADD the total amount (determined with reference to paragraphs 94(2)(*b*), (*d*), (*i*), (*p*) and (*q*) and subsection 94(9)) of contributions

made to the trust by the entity, to the extent that this amount exceeds the total of the first three amounts;

- SUBTRACT previous recoveries by the Canada Customs and Revenue Agency ("CCRA") under subsection 94(3) (or under subsection 94(1) as it read before 2002) from the entity in respect of the trust and the year or a preceding taxation year of the trust; and

- SUBTRACT previous recoveries by the CCRA under subsection 94(3) (or under subsection 94(1) as it read before 2002) from a specified party in respect of the particular entity in respect of the trust and the year or a preceding taxation year of the trust, to the extent that any amount so recovered represents the payment of a liability of the particular entity for an amount that is included in the total determined by paragraph 94(8)(*a*) (i.e., the total of amounts described in the first 3 bullets above).

For more detail on the expression "specified party" as defined in new subsection 94(10), see the commentary on that provision.

Subsection 94(9) affects the calculation of the amount of a "contribution" (as defined in new subsection 94(1)) to a trust of "specified property" (as defined in new subsection 94(10)) for the purpose of determining whether the "recovery limit" limitation applies to a contributor to the trust and of determining the amount of that recovery limit.

The amount of a contribution to a trust because of a transfer to the trust of specified property is deemed by subsection 94(9) to be the greater of:

- the amount, otherwise determined, at that time of the contribution; and

- the amount that is the greatest fair market value of the specified property (or of substituted property) in the period that begins immediately after that time and ends at the end of the third calendar year after that time.

For more detail on the expression "specified property" as defined in new subsection 94(10), see the commentary on that provision.

Subsection 94(9) allows for a reasonable opportunity for recovery of tax by the CCRA in the context of a transaction or series of transactions involving the transfer of specified property. Consider, for example, an estate freeze under which common shares in the capital stock of a corporation are transferred directly or indirectly to a non-resident trust. Because of the difficulties associated with valuing the common shares at the time of the transfer, it is appropriate to provide for a valuation as described above.

In conjunction with new subsection 94(9), subparagraph 152(4)(*b*)(vi) of the Act is amended to ensure that a reassessment of a taxpayer arising out of the application of subsection 94(9) can be undertaken by the CCRA within 3 years after the normal reassessment period of the taxpayer in respect of the taxpayer's relevant taxation year.

Definitions – Subsections 94(8) and (9)

ITA
94(10)

New subsection 94(10) of the Act defines certain expressions used in that subsection and subsections 94(8) and (9).

"specified controlled foreign affiliate"

For the purpose of the definition "specified party" in subsection 94(10), a "specified controlled foreign affiliate" of a particular entity at any time means an entity that would, at that time, be a controlled foreign affiliate of the particular entity if the particular entity were resident in Canada at that time.

"specified party"

New subsection 94(8) of the Act provides a rule for calculating an entity's recovery limit for the purpose of determining under subsection 94(7) of the Act the extent of an entity's limitation on liability arising under new paragraph 94(3)(*d*). For the purpose of that rule, a "specified party" in respect of a particular entity at any time means an entity that is at that time:

- under paragraph (*a*) of the definition, an individual who is a spouse or common-law partner of the particular entity;

- under paragraph (*b*) of the definition, a "specified controlled foreign affiliate" (as described in the commentary immediately above) of the particular entity, or of a spouse or common-law partner of the particular entity; and

- under paragraph (*c*) of the definition, an entity for which it is reasonable to conclude that the benefit referred to in subparagraph 94(8)(*a*)(iii) of the Act (i.e., a benefit received or enjoyed under a trust) was conferred in contemplation of the entity becoming after that time a "specified controlled foreign affiliate" of an entity referred to in subparagraph (*b*)(i) or (ii) of the definition.

"specified property"

New subsection 94(9) of the Act affects the calculation of the amount of a transfer to an entity or a "contribution" (as defined in new subsection 94(1)) to a trust of "specified property". For this purpose, "specified property" means:

- a share of the capital stock of a corporation, a beneficial interest in a trust, an interest in a partnership, an interest in any other entity;

- a right to acquire property described in the bullet above; or

- any other property deriving its value primarily from property described in either of the bullets above.

Where Contributor Becomes Resident in Canada Within 60 Months after Contributing

ITA
94(11)

New subsection 94(11) of the Act applies to determine whether there is a "connected contributor" (as defined in new subsection 94(1)) to a trust for the purpose of applying the definition "resident beneficiary" (as defined in new subsection 94(1)). Under new paragraph 94(3)(*d*) of the Act, a resident beneficiary can, to an extent, be liable for the trust's income tax under Part I of the Act. For more detail, see the commentary on those definitions and subsections 94(3) and (7) to (10).

A "contribution" (as defined in new subsection 94(1)) to a trust by a contributor is considered to have been made at a time other than a "non-resident time" (as defined in subsection 94(1)) if the contributor becomes resident in Canada at any time within the period (referred to in this commentary as the "60-month post period") 60 months after the time of the contribution. However, to facilitate the administration of the definitions "non-resident time" and "connected contributor" and subsection 94(3), the definition "non-resident time" is drafted so that such a contributor and the trust may, subject to subsection 94(11), treat the time of the contribution as a non-resident time for the purposes of applying the definition "connected contributor" and subsection 94(3) at the end of any particular trust taxation year if at the end of that particular year the contributor still has not become resident in Canada within the 60-month post period.

Subsection 94(11) deems (for the purpose of applying the definition "connected contributor" at the end of each taxation year of the trust that ends before the particular time at which the contributor becomes resident in Canada within the 60-month post period) the contribution to have been made at a time other than a "non-resident time" (as defined in subsection 94(1)) of the contributor if:

- in applying the definition "non-resident time" as of the end of each of those taxation years, the particular contribution was made at a non-resident time of the contributor; and

- in applying the definition "non-resident time" at the particular time, the contribution is made at a time other than a non-resident time of the contributor.

Where subsection 94(11) applies, the contributor will be considered a "connected contributor" to the trust and, if there was a "resident beneficiary" at the end of the relevant prior taxation year of the trust, the trust and the resident beneficiary would, because of subsection 94(3), generally be jointly and severally and solidarily liable for Part I tax on the trust's income for the year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Subparagraph 152(4)(*b*)(vi) of the Act is amended to ensure that a reassessment of a taxpayer arising out of the application of subsection 94(11) can be undertaken by the Canada Customs and Revenue

Agency within 3 years after the normal reassessment period of the taxpayer in respect of the taxpayer's relevant taxation year.

Clause 11

Foreign Investment Entities – Accrual Treatment

ITA
94.1

Existing section 94.1 of the Act applies where a taxpayer has invested in an offshore investment fund and one of the main reasons for the investment is to reduce or defer the tax liability that would have applied to the income generated from the underlying assets of the fund if such income had been earned directly by the taxpayer. In these circumstances, existing section 94.1 generally requires an amount to be included in computing the taxpayer's income from the investment. This amount is determined, in general terms, by multiplying the cost amount of the taxpayer's investment by a factor based on interest rates prescribed under Part XLIII of the *Income Tax Regulations*.

Section 94.1 is replaced by provisions in new sections 94.1 to 94.3, which contain rules governing the tax treatment of interests in foreign investment entities (FIEs). In computing a taxpayer's income for a taxation year, where a taxpayer so elects in respect of an investment in a FIE and has sufficient information to comply, new section 94.1 generally requires the inclusion of the taxpayer's share of the FIE's income for each of the FIE's taxation years that ends in the taxpayer's taxation year. New section 94.2 applies in place of the rules in section 94.1 in all other cases. Under section 94.2, a taxpayer must take into account the annual increase or decrease in the fair market value of the taxpayer's interest in a FIE in computing the taxpayer's income from the FIE. Section 94.3 is designed to prevent double taxation with respect to amounts included in income under sections 94.1 and 94.2.

New section 94.1 generally applies to taxation years, of Canadian investors, that begin after 2001.

The table below provides an overview of new sections 94.1 to 94.3 and related provisions.

Issue	Summary	References
1. Who is subject to the new FIE rules?	A. All taxpayers, except exempt taxpayers. Except as indicated in (C), below, FIE rules do not apply to non-resident taxpayers.	S.94.1(2) to (4) and 94.2(3) and (4). "Exempt taxpayer" (s.94.1(1)). Non-resident taxpayers: see also s.94.1(3) and 94.2(5).
	B. Partnerships with members resident in Canada must allocate FIE income to those members.	Existing section 96, including exception in s. 96(1.9). See also s. 94.2(6) for application to cases where partnership members become resident in Canada.
	C. Controlled foreign affiliates.	New s. 95(2)(*g*.2).
2. What property is subject to the new FIE rules?	A. Participating interests (other than exempt interests) in foreign investment entities. However, if no taxation year of a FIE has ended before the end of the taxpayer's taxation year, the FIE rules do not apply to the taxpayer for the taxpayer's year in respect of the FIE.	S. 94.1(2). The following definitions in s. 94.1(1): "entity", "non-resident entity", "foreign investment entity", "exempt interest" and "participating interest".
	B. Where property described in (A) is convertible into or exchangeable for or confers a right to acquire property or is not capital property, it is not subject to section 94.1 but it is subject to s. 94.2.	S. 94.1(4) and 94.2(3).
	C. Interests in non-resident entities, where those interests track returns in respect of investment property. This property is subject only to s. 94.2, not to s. 94.1.	S. 94.2(9). See also amended s. 91(1).
	D. Interests in certain foreign insurance policies. This property is subject only to s. 94.2, not s. 94.1.	S. 94.2(10).

Issue	Summary	References
3. What is the difference in the tax treatment of FIE interests between s. 94.1 and s. 94.2?	A. Section 94.1. Taxes investor's "share" of a FIE's income (e.g., does not include FIE's share of unrealized gains).	S. 94.1(3).
	B. Section 94.2. Full appreciation/decline in fair market value of the investment is recognized on an annual basis.	S. 94.2(4) S. 94.2(19)
4. How will foreign affiliates of taxpayers resident in Canada be treated under new FIE rules?	Subject to s. 94.2(9) (tracked interests), a taxpayer's share of the capital stock of a controlled foreign affiliate is exempt from the new FIE rules. In certain cases, a taxpayer can elect to have a foreign affiliate treated as a controlled foreign affiliate.	Paragraph (*a*) of the definition "exempt interest". S. 94.1(12).
5. If a non-resident corporation that is a FIE pays out dividends, how are these dividends taxed?	A. General principle: existing rules apply.	Existing s. 90 and 113.
	B. Relief provided to prevent double taxation. This relief extends to taxable distribution from other FIEs (e.g., trusts).	S. 94.3.
	C. Special rules in the event that the dividends paid to another FIE.	S. 94.1(5)A(*g*).
6. In what circumstances is a taxpayer subject to sections 94.1 and 94.2, respectively?	A. S. 94.2 rule applies, except as expressly provided otherwise.	S. 94.1(2) to (4) and s. 94.1 (3).
	B. Election to use s. 94.1 available.	S. 94.1(4)
	C. Requirement to use s. 94.2 where insufficient information to use s. 94.1.	S. 94.1(17)
	D. Requirement for FIEs to calculate own income with reference to s. 94.2.	S. 94.1(4)(*e*)
	E. Requirement to use s. 94.2 in the case of properties described in 2(B), (C) and (D), above.	See references in 2(B), (C) and (D).

Definitions

ITA
94.1(1)

New subsection 94.1(1) of the Act defines a number of expressions for the purpose of section 94.1. These definitions are also relevant for the purposes of sections 94.2 and 94.3.

"carrying value"

The "carrying value" of a property held by an entity at any time means:

- the amount at which the property would be valued at that time for the purpose of the entity's balance sheet, if the balance sheet were prepared in accordance with generally accepted accounting principles used in Canada or accounting principles substantially similar to generally accepted accounting principles used in Canada and included the property that is deemed under subsection (10) (i.e. property held by certain entities in which the entity has a significant interest) to be owned by the entity at that time, or

- if the taxpayer elects in writing in the taxpayer's return of income for the taxpayer's taxation year that includes that time, the carrying value is the amount representing the fair market value of the property at that time as determined in accordance with generally accepted accounting principles used in Canada or generally accepted accounting principles substantially similar to generally accepted accounting principles used in Canada

Subsection 94.1(15) also provides a series of rules that relate to the determination of the carrying values of assets of the entity. The commentary to subsection 94.1(15) provides further information in this regard.

The carrying value of property is relevant primarily for the purpose of determining whether a non-resident entity is a FIE. This determination is made at the end of the entity's taxation year. (For further detail, see the commentary on the definition "foreign investment entity".)

It should also be noted that subsection 94.1(10) provides for a "look-through" rule that can affect the properties considered to be owned by an entity and the carrying values of the entity's properties. In particular, the rule in subsection 94.1(10) can impute to an entity property owned by certain other entities in which the entity has a significant interest. For the purposes of the look-through rule, the time at which the determination of carrying value is made is the end of the taxation year of the first tier non-resident entity (whether or not lower tier entities share the same taxation year). For further detail, see the commentary to new subsection 94.1(10).

"entity"

An entity includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust. It does not include a individual.

"exempt interest"

An "exempt interest" of a taxpayer in a FIE is defined to include each of the following properties:

- A participating interest held by the taxpayer in a controlled foreign affiliate of the taxpayer (including an affiliate that is a controlled foreign affiliate because of an election under new subsection 94.1(12)),

- A participating interest that is mark-to-market property (as defined in subsection 142.2(1)) held by a financial institution (as defined in that same subsection).

- A participating interest in a testamentary trust, provided the interest has not been acquired for consideration.

- A participating interest in a FIE resident in a country where there is a prescribed stock exchange if the interests are listed on a prescribed stock exchange and are widely held and actively traded and there is no tax avoidance motive for acquiring the interest. For more details see the commentary to subsection 94.1(1.1) which defines "tax avoidance motive".

- A participating interest in a FIE if, throughout that part of the taxpayer's taxation year that includes the time during which the taxpayer held the participating interest, the FIE was a qualifying entity. (see the commentary to the definition "qualifying entity")

- A participating interest in a FIE that is a right under an employee stock option or similar agreement to acquire a participating interest in the FIE if

  1. the right was granted by the FIE or another entity with which it does not deal at arm's length;

  2. the taxpayer acquired the right at a time when the taxpayer dealt at arm's length with the entity that granted the right; and

  3. the taxpayer was entitled to acquire the right solely because the taxpayer was employed by the FIE or the other entity with which the FIE did not deal at arm's length.

- A participating interest in a FIE held by the taxpayer if all or substantially all of the carrying value of the FIE's property can be attributed to participating interests in an entity that is the employer of the taxpayer or an entity related to such an employer and the FIE allocates, within its taxation year that includes that time or within 120 days after the end of that taxation year, all or substantially all of its income, profits and gains for that taxation year to the interest holders and the taxpayer includes the taxpayer's share of such income in computing the taxpayer's income for the taxpayer's taxation year in which the allocation is made.

- A participating interest held by the taxpayer in a FIE that was formed, organized or continued under and is governed by the laws of a country (other than a prescribed country) with which Canada has entered into a tax treaty and under that treaty, if

  1. throughout the period in the taxpayer's taxation year that includes that time during which the taxpayer held the participating interest, the FIE is resident in that treaty country under the tax treaty;

  2. participating interests in the FIE that are identical to the participating interest are widely held and actively traded

throughout that part of the taxpayer's taxation year, that includes that time, during which the taxpayer held the participating interest; and

3. the taxpayer did not have a tax avoidance motive for acquiring the interest. For more details on tax avoidance motive, see the commentary concerning subsection 94.1(1.1).

- A participating interest held by the taxpayer in a FIE that was formed, organized or continued under and is governed by the laws of a country (other than a prescribed country) with which Canada has entered into a tax treaty (treaty country) if

1. throughout the period in the taxpayer's taxation year that includes that time during which the taxpayer held the participating interest the FIE is resident in that treaty country under the tax treaty;

2. the taxpayer is resident in Canada throughout that period;

3. the taxpayer is liable for income tax in the treaty country for that taxation year because the taxpayer is a citizen of the treaty country; and

4. the taxpayer did not have a tax avoidance motive for acquiring the interest. For more details on tax avoidance motive, see the commentary concerning subsection 94.1(1.1).

The rules in subsection 94.1(15) are relevant in determining whether an interest in a foreign investment entity is an exempt interest. The commentary in those notes are relevant for this commentary.

The rules in subsection 94.1 and 94.2 (subject to the rules in subsections 94.2(9) and (10) dealing with tracking shares and insurance policies) do not apply to a taxpayer in respect of an exempt interest in a foreign investment entity.

"exempt taxpayer"

An individual is an "exempt taxpayer" for a taxation year where the individual, before the end of the year, was a resident of Canada for a period of, or periods the total of which is, 60 months or less.

(Children who have always been resident in Canada cannot fall within the 60-month exception.)

The rules in new sections 94.1 and 94.2 do not apply in respect of periods during which a taxpayer is an exempt taxpayer (paragraph 94.1(2)(*a*) and subsections 94.2(9) and (10)). The 60-month exemption for new immigrants to Canada is similar to an exemption in the rules for non-resident trusts in existing section 94.

Except as indicated below, tax-exempt entities to which subsection 149(1) applies are also exempt taxpayers. Retirement compensation arrangements and qualifying environmental trusts for which alternative income tax rules are provided under Parts XI.3 and XII.4 and insurers to which paragraph 149(1)(*t*) applies are not exempt taxpayers.

The express reference to tax-exempt entities is generally of significance for the purposes of calculating Part I tax only in the context of the narrow circumstances to which new subsection 94.2(16) applies. That subsection contemplates a case where a taxpayer ceases to be an "exempt taxpayer" and subsequently becomes an "exempt taxpayer". However, the reference to tax-exempt entities may also be of significance in the context of Part XI (foreign property limits), given that the application of sections 94.1 and 94.2 has an impact on the cost amount of participating interests in FIEs.

"foreign bank"

The definition "foreign bank" has the same meaning as in subsection 95(1). The expression is used in the definition "investment business".

"foreign investment entity"

The new tax regime for FIEs in sections 94.1 and 94.2 generally applies only to participating interests in a "foreign investment entity".

A non-resident entity is generally a "foreign investment entity" throughout one of its taxation years if the total carrying value of its investment property is greater than 50% of the total carrying value of all of its property at the end of the year. In making this determination, the entity's property must be identified as either

investment property or other property and it must be assigned a carrying value.

A foreign investment entity does not, however, include:

- an "exempt foreign trust" under subsection 94(1) (other than a widely-held mutual fund trust referred to in paragraph (*c*) of the definition "exempt trust" in existing subsection 233.2(1)),

- a discretionary personal trust (or, more precisely, a personal trust that is not a "non-discretionary trust"),

- a partnership, or

- an entity the principal business of which is not an investment business.

The new rules are designed so that, in the case of partnerships, members' shares of incomes and losses are allocated in accordance with section 96 (including new subsection 96(1.9), described in the commentary below).

For more detail, see the commentary on the expressions "entity", "non-resident entity", "investment property" and "carrying value" in subsection 94.1(1). "Non-discretionary trust" is newly defined in subsection 248(1), with reference to the definition of the same expression in subsection 17(15).

Special rules are provided in subsections 94.1(10), (13) and (15) for the purpose of determining if a non-resident entity falls within the definition "foreign investment entity".

"investment business"

The expression "investment business" is used in the definitions "foreign investment entity", "investment property" and "qualifying entity". The definition "investment business" is similar to the definition of the same expression in existing subsection 95(1). However, in this definition:

- there is no exception for the lending of money or the insurance or reinsurance of risks;

- there is an accommodation for a trader or a dealer in securities or commodities;

- there is a greater accommodation of real estate businesses and businesses involved in the development of foreign and Canadian resource properties and timber resources;

- there is no explicit requirement for a specific number of full-time employees for the exceptions to the definition to apply;

- the supporting definitions and rules contained in subsections 95(1) to (2.4) are not relevant;

- there is accommodation for the leasing or licensing of produced or developed property; and

- there is accommodation for various combinations of businesses.

"investment property"

The expression "investment property" includes a list of specified properties. Most of the specified properties (e.g., shares, partnership interests, real estate and resource properties) are also specified in the definition of the same expression in subsection 95(1). In addition to the properties also specified in the definition in subsection 95(1), "investment property" held by a particular entity includes:

- an interest in an organization, fund or other entity;

- most derivative financial products; and

- interests, options and rights in respect of the above properties.

It should be noted, however, that "investment property" in subsection 94.1(1) does not include:

- property used or held principally in the course of carrying on a business, other than an investment business, carried on by the entity or a related entity;

- significant interests in qualifying entities;

- an interest in related entities or qualifying entities that have significant interest in the entity; and

- debt of related persons or persons that are qualifying entities in which the entity has a significant interest or a qualifying entity that has a significant interest in the entity.

The definition is relevant for the purpose of the determining whether a non-resident entity is a "foreign investment entity". Special rules in subsection 94.1(11) are used in determining significant interests in entities.

"non-resident entity"

One of the requirements for an entity to be a FIE to which sections 94.1 and 94.2 apply is that the entity must be a "non-resident entity". In this regard, it should be noted that, under proposed subparagraph 94(3)(*a*)(iii), certain trusts that would otherwise be non-resident are deemed (for certain limited purposes) to be resident in Canada for taxation years in which the trust has a resident contributor or a resident beneficiary. For further information see the commentary to new subsection 94(3).

In addition to non-resident corporations and trusts, a "non-resident entity" includes any other type of entity

- formed, organized, continued or existing under the laws of a country other than Canada, and

- governed under the laws of a country other than Canada.

"participating interest"

A "participating interest" in an entity means a share of the capital stock of corporation, a beneficial interest in a trust or an interest in any other type of entity. It also includes a property that is convertible into or exchangeable for or confers a right to acquire such a share, beneficial interest or interest in an entity or in a property the fair market value of which is determined primarily by reference to the fair market value of interests in the entity.

"qualifying entity"

The definition "qualifying entity" in a period means an entity all or substantially all of the carrying value of the property of which, throughout the period, is attributed to the carrying value of the following types of property.

1. Properties other than investment property.

2. Participating interests in or debts of other entities in which the entity has a significant interest if the other entity is an entity whose principal business is not an investment business or is a qualifying entity.

3. Participating interests in and debts of other entities whose principal business is not an investment business or an entity that is a qualifying entity in which the entity has a strategic interest.

   For this purpose an entity will be considered to have a strategic interest in another entity where the entity participates in or has established a plan of action for participating in the management and control of the other entity by reason of its status as a holder of a significant number (not to be confused with the "significant interest" definition) of participating interests in the other entity (in comparison with the number of participating interests held by each holder of interests in the entity) or an agreement with other such significant interest holders.

   In establishing if an entity actively participates in or exercises a significant influence over the governance or the management of an other entity the following facts (among others) will be considered:

   - whether the entity, alone or in alliance with others, appoints members of the board of director and management;

   - whether the entity, alone or in alliance with others, significantly influences the appointment of members of the board of director and management; and

   - whether the entity, alone or in alliance with others, is actively involved in the strategic planning for the entity.

In determining if an entity is carrying out a plan of action for the purpose of obtaining its objective of actively participating in or exercising significant influence over the governance or the management of another entity, all factors will be considered. For example, an entity's board-approved plan of action, board minutes, investment studies and other material relating to the strategic investment will be considered. As well, evidence that increasing numbers of shares of the other entity are being bought or that property is being sold in order to raise money to acquire such shares will be considered important factors. The entity's investment history and patterns will also be considered.

4. Property obtained to fund the purchase of participating interests described above.

"taxation year"

The "taxation year" of a non-resident entity is a calendar year, unless the entity is a corporation or an individual. Where the non-resident entity is an individual or a corporation, the definition in subsection 248(1) will apply.

Tax Avoidance Motive

ITA
94.1(1.1)

New subsection 94.1(1.1) of the Act sets out the conditions under which a taxpayer will be considered to have a tax avoidance motive in respect of a participating interest in a FIE. Subject to new subsection 94.1(1.3) (described in the commentary below), a tax avoidance motive will be considered to exist where one of the main reasons for acquiring a participating interest in a FIE was to permit the taxpayer to achieve the following two objectives:

- to derive a benefit all or substantially all of the value of which can be attributed, directly or indirectly, to income derived from investment property, to profits or gains from the disposition of investment property, or to an increase in value of investment property, and

- to defer or reduce the amount of tax that would have been payable by the taxpayer if the taxpayer had earned or realised such income, profits or gains from the investment property at the time they were earned or realised by the holders of the investment property.

Factors Considered in Tax Avoidance Motive

ITA
94.1(1.2)

New subsection 94.1(1.2) of the Act sets out factors to be considered in determining whether or not there is a tax avoidance motive for a taxpayer acquiring an interest in a FIE. Those factors are similar to the ones in existing subsection 94.1(1). However, the form and the terms and conditions governing the taxpayer's interest in a FIE are to be taken into account as well. They are as follows:

- the nature, organization and operation of the FIE and any other FIE in which it has a direct or indirect interest,

- the form of and the terms and the conditions governing the taxpayer's interest in or connection with the FIE,

- the direct or indirect interest of the taxpayer in any other FIE,

- the form of and the terms and the conditions governing the entity's direct or indirect interest in any other FIE,

- the extent to which the FIE and any other FIE in which the entity has a direct or indirect interest is subject to income tax on its income, profits and gains, and

- the extent to which the income, profits and gains from the FIE and any other FIE in which the entity has a direct or indirect interest for each fiscal period are taxed in the hands of the interest holders in the fiscal period or in the immediately following fiscal period.

No Tax Avoidance Motive

ITA
94.1(1.3)

New subsection 94.1(1.3) of the Act provides two situations where a taxpayer will not be considered to have a tax avoidance motive in respect of a participating interest in a FIE:

- participating interests in an entity where the interests are widely held and actively traded and the entity and entities in which the entity has a direct or indirect interest allocated to their interest holders all or substantially all of their income for a year within 120 days of the end of the year; and

- participating interests in an entity that is a "Regulated Investment Company" for the purposes of sections 851(b) and 852(a) of the United States *Internal Revenue Code*.

Conditions for Application of Tax Regime for Foreign Investment Entities

ITA
94.1(2) to (4)

New subsection 94.1(2) of the Act sets out the common conditions for the application of the FIE rules in section 94.1(3) (accrual regime) and 94.2(4) (mark-to-market regime). For the accrual or mark-to-market regimes to apply to a taxpayer for a particular taxation year of the taxpayer in respect of a participating interest held in the particular year by the taxpayer in a non-resident entity, all of the following conditions set out in subsection 94.1(2) must be satisfied:

- the taxpayer is not an "exempt taxpayer" for the particular year;

- the taxpayer held the participating interest at the end of a taxation year of the non-resident entity that ended at or before the end of the particular year; and

- at the end of that taxation year of the non-resident entity, the interest was a participating interest in a FIE and was not an exempt interest.

Notwithstanding the above, the mark-to-market regime, rather than the accrual regime, applies where the exceptions under subsection 94.1(4) apply. Subsection 94.1(4) provides that the accrual regime applies only to capital property and only where an election to use the accrual regime has been made at the earliest opportunity. Moreover, the accrual regime does not apply to a taxpayer for a taxation year in respect of a participating interest in a non-resident entity in the following cases:

- where section 94.1 does not apply because of the operation of subsection 94.1(17) (insufficient information),

- where, because of subsection 94.2(9) (tracked interests), subsection 94.2(3) applies or has applied to the taxpayer in respect of the participating interest or identical participating interests,

- where the taxpayer is itself a FIE, or

- where the participating interest or each identical participating interest in the FIE is an option, a property that is convertible into or exchangeable for or confers a right to acquire a participating interest in a FIE or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the FIE.

Where the accrual regime applies to a taxpayer for a particular taxation year in connection with one or more of a taxpayer's identical participating interests in a FIE, subsection 94.1(3) provides that:

- The taxpayer's "income allocation" in respect of those interests for a taxation year of the entity ending in the particular year is added in computing the amount included in the taxpayer's income as income from property to the extent that the taxpayer held those interests at the end of the entity's year. However, in order to clarify the application of section 114 to part-year residents and to ensure that section 94.1 does not affect the taxability of non-resident taxpayers, subsection 94.1(3) does not apply to a taxpayer for a taxation year where the taxpayer is not resident in Canada at the end of the FIE's year.

- The taxpayer's "loss allocation" in respect of participating interests in a FIE is deductible in computing the taxpayer's income from

property to the extent that there has previously been a net cumulative positive balance determined under subsection 94.1(3) in respect of the taxpayer for such property in respect of preceding taxation years of the FIE. An unused loss allocation is treated as a loss from property and is carried forward to offset the total amount otherwise required to be included in computing the taxpayer's income from property under subsection 94.1(3) in respect of identical participating interests for a subsequent taxation year of the FIE.

- A taxpayer's specified tax allocation in respect of the FIE's particular year is treated in the same way as a loss allocation. However, unlike a loss allocation, a specified tax allocation can arise for the same year of the FIE as an income allocation. Where this is the case, the specified tax allocation can directly offset the income allocation. A taxpayer's specified tax allocation, as determined under subsection 94.1(8), represents the taxpayer's share of income or profits upon which foreign tax was paid by the FIE. For this purpose, the taxpayer's share of taxes in respect of the particular year is determined with reference to the taxpayer's position in the entity at the end of that year.

The examples after the commentary on subsections 94.1(5) and (6) illustrate the operation of subsection 94.1(3).

Income Allocation

ITA
94.1(5) and (6)

New subsection 94.1(5) of the Act provides for the calculation of a taxpayer's income allocation in respect of participating interests in a FIE. A taxpayer's income allocation in respect of one or more identical participating interest in a FIE held by the taxpayer at the end of the FIE's taxation year is included in computing the taxpayer's income under subsection 94.1(3). In general terms, a taxpayer's income allocation in respect of a participating interest in a FIE is the proportion of the FIE's income for a taxation year ("A" in the formula in subsection 94.1(5)) that the fair market value of the interest ("B" in the formula) is of the fair market value of all participating interests in the FIE ("C" in the formula).

The calculation of a taxpayer's income allocation in respect of a FIE depends on a calculation of income for the FIE in accordance with rules set out in paragraphs (*a*) to (*l*) of the description of "A" in the formula. This permits taxpayers to make independent calculations of a FIE's income for the purpose of determining income allocations under section 94.1 for the FIE's fresh-start year in respect of the taxpayer and subsequent years. A fresh-start year of a FIE in respect of a taxpayer is defined in subsection 94.1(6) as a taxation year of an entity at the end of which it becomes an entity the income from which must be reported under section 94.1 or 94.2.

The special rules that apply in calculating a FIE's income in respect of a taxpayer that is a participating interest holder for the FIE's fresh-start year and subsequent years are as follows:

(a) Subject to three exceptions, the FIE is generally treated as having been a taxpayer resident of Canada throughout its existence. First, this rule does not apply for the purposes of subsection 107.4(1) or paragraph (*f*) of the definition "disposition" in subsection 248(1), with the result that property that is transferred to the FIE without there being any change in the beneficial ownership of the property is considered to have been transferred to the FIE under subsection 69(1) at its fair market value. Second, this rule does not apply for the purpose of section 91 with the result that the FIE will not itself be required to include an amount in respect of foreign accrual property income in computing the FIE's income. Third, this rule does not apply for the purpose of paragraph 94.1(4)(*e*) with the result that section 94.2 (rather that section 94.1) potentially applies in the event that the FIE owns a participating interest in another FIE.

(b) Each property held by the FIE at the beginning of the fresh-start year is deemed to have been disposed of for its fair market value immediately before that time and reacquired for the same amount at that time.[1]

(c) Each discretionary deduction permitted in computing the FIE's income for the FIE's fresh-start year and subsequent taxation years is deemed to have been claimed to the extent designated by the

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[1] Paragraph 94.1(5)A(*b*). Compare paragraph 149(10)(*b*).

investor taxpayer. Thus, in calculating an income allocation in respect of the FIE, the investor taxpayer will be permitted to claim deductions such as capital cost allowance.[2]

(d) The FIE is assumed to have deducted the greatest amounts permissible, for its taxation year preceding the fresh-start year, under sections 20, 138 and 140.[3] These amounts are added in computing the FIE's income for the fresh-start year, but appropriate deductions under these sections can be claimed for the fresh-start year and subsequent taxation years. In the context of the reserve for life insurers under subsection 138(3), it is intended to amend paragraph (*c*) of the definition "reported reserve" in subsection 1408(1) of the Regulations so that the FIE can have a "reported reserve".

(e) The FIE is deemed not to have been in existence before the fresh-start year for the purposes of sections 37, 65 to 66.4 and 66.7.[4] As a consequence, the scientific research and resource expenditure pools to which these sections refer are ignored, to the extent that these pools were generated before the fresh-start year.

(f) The FIE is not permitted to deduct any amount under subsection 20(11) or (12) in respect of its foreign tax.[5] However, foreign tax will be taken into account because the FIE's specified tax allocation (as determined under new subsection 94.1(8)) can offset amounts otherwise included in income under subsection 94.1(3). Further, if the FIE is a trust, no amount is considered deductible under subsection 104(6) in determining its income for the year.[6] Double taxation for the investor taxpayer is avoided through the application of new subsection 94.3(2). In addition, no deemed disposition day under subsection 104(4) is determined in respect of the trust, whether or not the FIE falls outside the restricted meaning of "trust" for this purpose under subsection 108(1).

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[2] Paragraph 94.1(5)A(*c*).

[3] Paragraph 94.1(5)A(*d*). Compare paragraph 149(10)(*a*.1).

[4] Paragraph 94.1(5)A(*e*). Compare paragraph 149(10)(*c*).

[5] Paragraph 94.1(5)A(*f*).

[6] Paragraph 94.1(5)A(*f*).

(g) If the investor taxpayer is a corporation resident in Canada and the FIE is a foreign affiliate of the taxpayer, any dividends received by the FIE from a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest (as determined under paragraph 95(2)(*m*)) are not included in the FIE's income.[7] Note, that this rule does not apply in the event that the FIE's interest in the foreign affiliate is subject to the mark-to-market regime in subsection 94.2(4). However, an income inclusion resulting from the application of subsection 94.2(4) for the FIE can, in some cases, be offset by the deduction provided under new subsection 94.3(2).

(h) Where the FIE has an interest in another FIE, there is no "deferral amount" taken into account in computing the FIE's income pursuant to new subsection 94.2(4).[8] (The fresh-start rule described above eliminates the need for a "deferral amount".)

(i) Participating interests in controlled foreign affiliates of the investor taxpayer (rather than controlled foreign affiliates of the FIE) are treated as "exempt interests" of the FIE.[9]

(j) Where the FIE has net capital gains for the particular taxation year, the amount to be included in computing the FIE income in respect of the capital gains is the amount, if any, by which the amount determined under subparagraph 3(*b*)(i) exceeds the amount determined under subparagraph 3(*b*)(ii) in respect of the FIE for the year.

(k) Where the FIE has net capital losses for the particular taxation year the amount deductible in computing the FIE income in respect of capital losses (other business investment losses) is the amount, if any, by which the amount determined under subparagraph 3(*b*)(ii) exceeds the amount determined under subparagraph 3(*b*)(i) in respect of the FIE for the year.

(l) Where the FIE has business investment losses for the year the amount deducted in computing the entity's income for the year in

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[7] Paragraph 94.1(5)A(*g*).
[8] Paragraph 94.1(5)A(*h*).
[9] Paragraph 94.1(5)A(*i*).

respect of business investment losses is the amount of its allowable business investment losses for the year.

For further details, see the related commentary on the expressions "foreign investment entity", "exempt interest" in subsection 94.1(1), as well as the commentary on subsection 94.1(7) (loss allocation) and subsection 94.1(8) (specified tax allocation).

The examples below illustrate the operation of subsections 94.1(3) and (5). It should be noted in this context that any negative amount otherwise resulting from the formula in paragraph 94.1(3)(*a*) is deemed to be nil as a result of the application of section 257.

Example 1

Canco owns shares in the capital stock of FIE-1, which like Canco has a calendar taxation year. Canco's income (loss) allocations for, 2002, 2003, 2004, 2005 and 2006 are ($100), $25, $90, ($20) and $50, respectively.

Results

1. *The amount included under subsection 94.1(3) in Canco's income for 2002 is nil (B = $100). The amount determined under paragraph 94.1(3)(b) for 2002 is $100, which can be carried forward to 2003.*

2. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2003 is nil (A = $25, D = $100). The amount determined under paragraph 94.1(3)(b) for 2003 is $75, which can be carried forward to 2004.*

3. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2004 is $15 (A = $90, D = $75). The amount determined under paragraph 94.1(3)(b) for 2004 is nil.*

4. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2005 is nil (B = $20, D = $0). The amount deductible under paragraph 94.1(3)(b) is $15 (= the lesser of $20 and $15). The remaining $5 unused loss allocation can be carried forward to 2006.*

5. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2006 is $45 (A = $50, D = $5).*

Example 2

Canco owns shares in the capital stock of FIE-1, which like Canco has a calendar taxation year. Canco's income (loss) allocations for, 2002, 2003, 2004, 2005 and 2006 are: ($100), ($125), ($175), $300 and $150.

Results

1. *The amount included under subsection 94.1(3) in Canco's income for 2002 is nil (B = $100). The amount determined under subparagraph 94.1(3)(b)(i) for 2001 is $100 (= B), which can be carried forward to 2003.*

2. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2003 is nil (B = $125, D = $100). The amount determined under subparagraph 94.1(3)(b)(i) for 2003 is $225 (= B+D), which can be carried forward to 2004.*

3. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2004 is nil (B = $175, D = $225). The amount determined under subparagraph 94.1(3)(b)(i) for 2004 is $400 (= B+D).*

4. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2005 is nil (A = $300, D = $400). The amount deductible under paragraph 94.1(3)(b) is nil (= the lesser of $100 and nil). The remaining $100 unused loss allocation (= D - A) can be carried forward to 2006.*

5. *The amount included under paragraph 94.1(3)(a) in Canco's income for 2006 is $50 (A = $150, D = $100).*

Example 3

1. *Canco, FIE-1 and ABC Inc. each have taxation years that coincide with calendar years and each issue only one class of shares.*

2. *Canco is a corporation resident in Canada that holds 20% of the shares of the capital stock of an FIE (FIE-1).*

3. *FIE-1 owns 75% of the shares of the capital stock of ABC Inc.*

4. *ABC Inc. is not a FIE, but would be a controlled foreign affiliate of FIE-1 if FIE-1 were resident in Canada. Although ABC Inc. is a foreign affiliate of Canco, it is not a controlled foreign affiliate of Canco.*

5. *FIE-1 earns $5,000 in interest income in 2002. It also receives a dividend of $1,000 from ABC Inc.*

6. *The fair market value of FIE-1's shares in ABC Inc. increases by $6,500 in 2002.*

Results

1. *Under subsection 94.1(3), Canco is required to include in computing income its income allocation in respect of its shares in the capital stock of FIE-1. For this purpose, FIE-1's income is generally computed as if FIE-1 were resident in Canada.*

2. *FIE-1's income includes the $5,000 of interest income (as per paragraph 12(1)(c)). However, the $1,000 dividend from ABC Inc. is disregarded because of paragraph 94.1(5)A(g). Because of the reference to section 91 in paragraph 94.1(5)A(a), it is not necessary to make any foreign accrual property income calculation in respect of ABC Inc.*

3. *Canco must therefore include $1,000 (i.e., 20% x $5,000) in computing its income because of subsection 94.1(3).*

Example 4

Same facts as in example 3, except that ABC Inc. is itself a FIE.

Results

1. *The mark-to-market rules in section 94.2 will apply in the calculation of FIE-1's income in respect of its interest in ABC Inc. See, in this regard, paragraph 94.1(4)(e).*

2. *For the purpose of computing Canco's income allocation in respect of its shares in FIE-1, FIE-1's income would include the $5,000 of interest (as per example 3), but not include any share of foreign accrual property income (as per example 3). However, FIE-1's income would include the $1,000 dividend paid in addition to its gain determined under subsection 94.2(4) in respect of its participating interest in ABC Inc. This gain so determined is $7,500, which is equal to the $6,500 increase in the value of shares plus the $1,000 dividend paid. However, for the purposes of computing Canco's income allocation, a deduction for the $1,000 dividend is permitted for FIE-1 because subsection 94.3(2) would have permitted the deduction if FIE-1 had been resident in Canada.*

3. *Consequently, Canco's income allocation in respect of its shares of the capital stock of FIE-1 is equal to $2,500 [i.e., ($5,000 + $7,500 + $1,000 - $1,000) x 20%)]. This amount is required to be included in computing Canco's income under subsection 94.1(3).*

Loss Allocation

ITA
94.1(7)

A taxpayer's "loss allocation" in respect of the taxpayer's participating interest in an entity is relevant for the purposes of determining the amounts deductible and included in computing income of a taxpayer from property under new subsection 94.1(3) of the Act. In general, a taxpayer's loss allocation in respect of a FIE is the proportion of the FIE's net loss for the year that the fair market value of the taxpayer's participating interest in the FIE is of the fair market value of all participating interests in the FIE. More specifically, a taxpayer's loss allocation in respect of a participating interest of a taxpayer in an entity for a taxation year of the entity is determined as follows:

- ADD the entity's total losses for the year from businesses and properties, the amount, if any, by which the amount determined under subparagraph 3(*b*)(ii) exceeds the amount determined under subparagraph 3(*b*)(i) in respect of the entity for the year and the

amount of the entity's allowable business investment losses for the year,

- SUBTRACT the amount determined under paragraph 3(*c*) for the entity for the year (i.e., the total amount of its income from businesses and properties and taxable capital gains in excess of allowable capital losses, for the year), and

- MULTIPLY any positive remainder by the percentage that the fair market value of the interest represents of the fair market value of all participating interests in the entity (other than a property that is convertible into or exchangeable for or confers a right to acquire a participating interest in a FIE or a property the fair market value of which is determined primarily by reference to the fair market value of participating interests in the FIE).

The determination of a taxpayer's loss allocation is subject to the same special rules that apply for the purposes of computing a taxpayer's income allocation under subsection 94.1(5) (e.g., the entity is generally deemed to be resident in Canada).

Specified Tax Allocation

ITA
94.1(8)

Under new subsection 94.1(3) of the Act, a taxpayer is entitled to deduct the taxpayer's specified tax allocation in computing income from a FIE, provided that sufficient amounts are otherwise included under subsection 94.1(3) in computing the taxpayer's income in respect of the FIE.

A taxpayer's specified tax allocation for an entity's taxation year in respect of a participating interest in an entity is determined under subsection 94.1(8). It represents the total of the taxpayer's share of income upon which income or profits tax has been paid by the entity for the entity's year and preceding taxation years. The taxpayer's share is based on the taxpayer's percentage fair market value interest in the entity at the end of each of the entity's taxation years to which the tax liability relates. The taxpayer's specified tax allocation is determined by multiplying the taxpayer's share of the taxes by the

taxpayer's relevant tax factor (2.63 for corporations and 2 for individuals).

Income or profits tax is normally expected to be tax that is paid by an entity to a foreign government. However, it could also include income tax paid to the government of Canada or a province with respect to income earned by the entity from Canadian sources. In each case, only income or profits tax payable for taxation years of entities that end in a taxation year of a taxpayer that begins after 2001 is taken into account.

The example below illustrates the operation of subsections 94.1(3) and (8).

Example

- *In 1999, Mireille (a resident of Canada) purchased a 30% participating interest in an entity (FIE-1) that is a FIE. The rate of foreign tax applicable to FIE-1's income is 20%. FIE-1's taxation years coincide with calendar years. For the purposes of computing Mireille's income allocation and loss allocation in respect of the interest, the income (loss) and the foreign tax of FIE-1 for taxation years 2002 to 2005 are as follows:*

Year	*2002*	*2003*	*2004*	*2005*	*Total*
Income (loss)	*$ 100,000*	*($120,000)***	*$95,000*	*$130,000*	*$205,000*
Foreign tax paid*	*$20,000*	*Nil*	*Nil*	*$21,000*	*$41,000*

* *Assume foreign tax paid in the same taxation year as liability arose.*

** *Assume that an equivalent amount is carried forward under the laws of the relevant foreign jurisdiction to reduce FIE-1's tax liabilities after 2003.*

Results

Mireille's income allocations, loss allocations and specified tax allocations are shown in the table below, as are the resulting income inclusions and deductions under subsection 94.1(3). The specified tax allocations in the table below are obtained by multiplying the related figures in the above table by 30% (Mireille's percentage interest) and 2 (specified tax factor for

Mireille). For example, for 2002 Mireille's specified tax allocation is $12,000 ($20,000 x 30% x 2).

Year	2002	2003	2004	2005
A. Income allocation	$30,000	nil	$28,500	$39,000
B. Specified tax allocation	$12,000	nil	nil	$12,600
C. Loss allocation (used)	nil	$18,000	nil	nil
D. Carry-forward offset used	nil	nil	$18,000	nil
E. Loss allocation/ tax allocation to carryforward	nil	$18,000	nil	nil
Amount included in income under subsection 94.1(3) (A - B - C - D)	$18,000	nil	$10,500	$26,400
Amount deducted in computing income under subsection 94.1(3) (D + C + B - A)	*nil*	*$18,000*	*nil*	*nil*

Adjusted Cost Base

ITA
94.1(9)

New subsection 94.1(9) of the Act provides for adjustments to the adjusted cost base (ACB) of a participating interest in an entity held by a taxpayer.

Paragraph 94.1(9)(*a*) provides for an addition to the ACB of a participating interest held by a taxpayer at the end of a taxation year of the entity, in respect of an amount included in computing the taxpayer's income under paragraph 94.1 (3)(*a*) in respect of the interest in the year and the portion of the product obtained when the amount determined under paragraph 94.1 (5)(*j*) (taxable capital gains of the FIE) is multiplied by the percentage that the fair market value of the interest represents of the fair market value of all participating interests in the entity.

Conversely, paragraph 94.1(9)(*b*) provides for a reduction to the ACB of a participating interest held by a taxpayer at the end of a taxation year of the entity, in respect of amounts deducted in computing the taxpayer's income under paragraph 94.1(3)(*a*) in respect of the interest in the year and the portion of the product obtained when the amount determined under paragraph 94.1(5)(*k*) (allowable capital losses of the FIE) is multiplied by the percentage that the fair market value of the interest represents of the fair market value of all participating interests in the entity, and the portion of the product obtained when the amount determined under paragraph 94.1(5)(*l*) (allowable business investment losses) is multiplied by the percentage that the fair market value of the interest represents of the fair market value of all participating interests in the entity.

Property Deemed Owned by an Entity

ITA
94.1(10) and (11)

New subsections 94.1(10) and (11) of the Act are relevant in determining whether a non-resident entity is a FIE. A non-resident entity is generally a FIE at any time if the carrying value of all of the entity's "investment property" is more than 50% of the "carrying value" of all its property at the end of the entity's taxation year that includes that time.

Where at any time an entity has a "significant interest" (as described below) in a corporation, partnership or non-discretionary trust (the investee), in determining the carrying value at that time of the entity's property, the carrying values of the entity's "participating interests" (as described in the commentary above) in the investee are deemed to be nil. Debt that is investment property and that is owing to the entity by the investee (other than debt acquired in the ordinary course of a business other than an investment business of the entity) is also deemed to have a carrying value to the entity of nil. Instead, the entity is deemed to own the property of the investee. Each such property is deemed to have a carrying value to the entity based on the product of the property's carrying value to the investee and a percentage based on:

- the entity's percentage relative ownership (determined with reference to fair market value) of shares or interests in the investee, and

- the entity's percentage relative ownership (determined with reference to fair market value) in debt issued by the investee (other than debts acquired in the ordinary course of a business, other than an investment business, carried on by the entity), to participating interest holders.

Where the taxpayer notifies the Minister of National Revenue in writing of its intention to value the entity 's property at its fair market value in accordance with paragraph (*b*) of the definition "carrying value" in subsection 94.1(1), the property of the investee must also be valued on that basis.

If there are tiers of entities each of which has a significant interest in the other, subsection 94.1(10) operates to deem the higher tier entities to own properties of lower tier entities on an iterative basis. For example, assume a non-resident entity (Foreignco-1) owns 100% of the shares in Foreignco-2, which in turn owns 100% of shares in Foreignco-3 and that Foreignco-1, Foreignco-2 and Foreignco-3 have identical taxation year ends. The carrying values from properties in Foreignco-3 would, under subsection 94.1(10), become the carrying values of properties in Foreignco-2. Because subsection 94.1(10) operates on an iterative basis, the carrying value of those properties would be considered to be the carrying values of properties held by Foreignco-1.

As well, the activities carried on by the investee, in which it used the property referred to above that are deemed to be owned by the entity, are deemed to have been carried on by the entity in the same proportion that the entity is deemed to own the above mentioned property. This is relevant for the purposes of the definition "investment business" and for the purpose of determining if an entity's principal business is an investment business.

New subsection 94.1(11) sets out the circumstances in which an entity is considered to have a "significant interest" in a corporation, partnership or non-discretionary trust for the purpose of subsection 94.1(10). An entity is considered to have a significant interest in a corporation, partnership, or non-discretionary trust where the entity or

a group of entities comprised of the entity and entities related to the entity holds shares or interests in the corporation, partnership or trust that have a fair market value equal to 25% or more of the fair market value of all the shares or interests in the corporation, partnership or trust and, in the case of a corporation, the entity or the group of entities comprised of the entity and the entities related to the entity has shares entitling the entity to cast at least 25% of votes at an annual shareholders' meeting of the corporation.

The example below illustrates the operation of subsection 94.1(10).

Example

1. *Jean, who resides in Canada, holds shares in Foreignco, a non-resident corporation that is not a controlled foreign affiliate of Jean. Foreignco's principal activity is the carrying on of investment activities on behalf of its shareholders. Foreignco prepares its financial statements in accordance with accounting principles substantially similar to generally accepted accounting principles used in Canada.*

2. *The carrying values of Foreignco's assets at the end of its taxation year ending in Jean's year are as follows:*

guaranteed investment certificate	*$10,000*
shares of XYZ Inc. in which Foreignco has a significant interest	*$20,000*
shares of ABC Inc. in which Foreignco does not have a significant interest	*$ 5,000*
cash	*$ 4,000*
Total assets	*$39,000*

3. *XYZ Inc. owns assets at that time that are used in the course of carrying on an active business, with a carrying value of $80,000. It also has investment property with a carrying value of $15,000.*

4. *The fair market value of the shares of XYZ Inc. held by Foreignco is $40,000 while the fair market value of all the issued and outstanding shares of XYZ Inc. is $100,000 at that time.*

Results

1. *The guaranteed investment certificate, cash, and the shares of XYZ Inc. and ABC Inc. are all investment property by virtue of the definition "investment property" in subsection 94.1(1).*

2. *However, since Foreignco owns a significant interest in XYZ Inc., the special look-through rule in new subsection 94.1(10) applies. Under this look-through rule the carrying value of Foreignco's shares in XYZ Inc. is deemed to be nil. Instead, Foreignco is deemed to own a portion of the property that XYZ Inc. owns.*

3. *The carrying value of the XYZ property deemed to be owned by Foreignco is 40% of its carrying value to XYZ, since Foreignco's percentage ownership of shares is 40%.*

4. *Consequently, the carrying values of the investment property of Foreignco are:*

guaranteed investment certificate	*$10,000*
shares of XYZ Inc.	*nil*
shares of ABC Inc.	*$ 5,000*
cash	*$ 4,000*
investment property of XYZ Inc. (40% of $15,000)	*$ 6,000*
Total	*$25,000*

5. *The total carrying value of the assets of Foreignco is:*

Investment property (see above)	*$ 25,000*
assets of XYZ Inc. (other than investment property) (40% of $80,000)	*$ 32,000*
Total	*$ 57,000*

6. *As a result, Foreignco is not a FIE because less than 50% of the carrying value of its property is investment property.*

Entity Treated as Controlled Foreign Affiliate

ITA
94.1(12)

New subsection 94.1(12) of the Act permits a taxpayer to make an irrevocable election to treat its foreign affiliate (including an affiliate the shares which are held by the taxpayer's controlled foreign affiliate) as a controlled foreign affiliate for a particular taxation year and subsequent taxation years. This one-time election is available only if:

- a taxation year of the affiliate ends at or before the end of the particular year, and

- the taxpayer has a "qualifying interest" (as defined in paragraph 95(2)(*m*)) in the affiliate.

The election must be made in prescribed form in the taxpayer's tax return for the year. However, under subsection 94.1(17), the election may be rendered invalid in the event that the taxpayer cannot provide sufficient information to the Minister of National Revenue for the Minister to be able to determine amounts required to be included in the taxpayer's income under section 91. In addition, the election ceases to have effect if the corporation ceases to be a foreign affiliate of the taxpayer.

In the period during which an election under subsection 94.1(12) is effective, a foreign affiliate of a taxpayer is deemed to be a controlled foreign affiliate of the taxpayer. As a result, a share issued by the affiliate to the taxpayer would be an "exempt interest" under the definition in subsection 94.1(1). Sections 94.1 and 94.2 generally would not apply to the taxpayer's participating interest in the affiliate. However, the foreign accrual property income (FAPI) rules would apply and the taxpayer would be required to include in income under section 91 a percentage of any FAPI derived by the affiliate in the year. Notwithstanding an election under subsection 94.1(12), section 94.2 may still apply in the event that a taxpayer's interest in a controlled foreign affiliate is a tracked interest to which subsection 94.2(9) applies.

Special Rules – re Determining Foreign Investment Income

ITA
94.1(13)

New subsection 94.1(13) of the Act provides a special rule under which property (which would otherwise be considered to be investment property) is deemed, in certain circumstances, not to be investment property for purposes of determining if an entity is a FIE.

To qualify for this treatment at any particular time, property must have been acquired by the entity within the 36 months preceding that time or, where written application has been made to the Minister of National Revenue by the taxpayer within 36 months of having acquired the property, within such longer period as the Minister considers reasonable in the circumstances, as a result of qualified activities. Those activities are

- the issuance of a debt or a participating interest in the entity;

- the disposition of property used in a business (other than an investment business) carried on by the entity or an entity related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*));

- the disposition of a participating interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business (other than an investment business) carried on by the other entity or an entity related to the other entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)); and

- the accumulation of income of the entity derived from a business (other than an investment business) carried on by the entity or an entity related to the entity (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)),

The qualified activities must also have been undertaken for the purpose of

- acquiring property to be used principally in or making expenditures for the purpose of earning income from a business (other than an

investment business) carried on by the entity or an entity related to the entity, or

- acquiring a participating interest that is a significant interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used or held principally in the course of earning income from a business, other than an investment business, carried on by the other entity.

Special Rules – re Determining Qualifying Entity Status

ITA
94.1(14)

New subsection 94.1(14) of the Act provides a special rule under which property (which would otherwise be considered to be investment property) is deemed, in certain circumstances, not to be investment property for purposes of determining if the entity is a qualifying entity.

To qualify for this treatment at any particular time, the property must have been acquired within the 36 months preceding that time (or where written application has been made to the Minister of National Revenue by the taxpayer within 36 months of having acquired the property, within such longer period as the Minister considers reasonable in the circumstances), as a result of qualifying activities. Those activities are

- the issuance of a debt or a participating interest in the entity;

- the disposition of property described in any of paragraphs (*a*) to (*d*) of the definition "qualifying entity"; and

- the accumulation of income of the entity.

The qualifying activities must also have been made for the purpose of acquiring property that, if owned by the entity, would be property described in paragraph (*a*) to (*d*) of the definition of "qualifying entity" in subsection 94.1(1).

Determination of Foreign Investment Entity and Exempt Interest Status

ITA
94.1(15)

New subsection 94.1(15) of the Act provides special rules for the purpose of determining whether a non-resident entity is a foreign investment entity and whether a participating interest is an exempt interest.

- Under paragraph 94.1(15)(*a*), financial statements of an entity made available to interest holders that are prepared in accordance with generally accepted accounting principles used in the United States of America or a country that is a member of the European Union are considered to be prepared in accordance with generally accepted accounting principles that are substantially similar to generally accepted accounting principles used in Canada if statements prepared in accordance with generally accepted accounting principles that are used in Canada are not made available to the interest holders. This rule is relevant for the definition "carrying value" in new subsection 94.1(1).

- Under paragraph 94.1(15)(*b*), the use of consolidated financial statements of an entity that are made available to interest holders is permitted where individual entity financial statements are not made available to interest holders. These statements must be prepared in accordance with principles that are, or that are substantially similar to, generally accepted accounting principles used in Canada. The entity must be resident in a country in which there is a prescribed stock exchange and participating interests in the entity must be listed on that or another prescribed exchange. This rule is also relevant for the purpose of the definition "carrying value" in new subsection 94.1(1).

- Under paragraph 94.1(15)(*c*), where consolidated statements are used, the activities of other entities whose assets and liabilities are included in the consolidated statements of an entity are considered to be carried on by the entity to the extent of the entity's interest in those other entities retained earnings.

- Under paragraph 94.1(15)(*d*), exchangeable participating interests in an entity that are in existence at a particular time are deemed to have been exchanged in accordance with their terms.

- Under paragraph 94.1(15)(*e*), in determining whether the principal business of an entity is an investment business at the end of a taxation year of the entity, the following rules apply:

  - where the accounting income of the entity from investment businesses and investment property exceeds the entity's accounting income from other businesses, the principal business is deemed to be an investment business,

  - where the accounting income of the entity from investment businesses and investment property is less than the entity's accounting income from other businesses, the principal business is deemed to be a business other than an investment business, and

  - in any other case, the facts and circumstances to be considered, including the utilization of assets and employees, expenditures made and the net income of the entity.

- Under paragraph 94.1(15)(*f*), the net accounting income of the entity for a taxation year is to be determined as the net income before extraordinary items and income taxes as shown in the entity's financial statements for the year prepared in accordance with principles that are, or that are substantially similar to, generally accepted accounting principles used in Canada.

- Under paragraph 94.1(15)(*g*), a participating interest in a FIE is deemed to be widely held if at least 150 persons who are dealing with each other at arm's length own such participating interests and each of those persons owns participating interests with a total value of at least $500.

- Under paragraph 94.1(15)(*h*), a particular participating interest in a FIE is deemed to be actively traded if such interests are listed on a prescribed stock exchange or they are qualified for distribution to the public under the relevant securities law of the country or of a political subdivision of which the entity was formed, organized or continued and is governed and the interests are bought and sold by

members of the public at large or can be purchased from and sold to the entity by members of the public at large.

Demand for Information

ITA
94.1(16) and (17)

New subsections 94.1(16) and (17) of the Act provide for the application of the mark-to-market rules in section 94.2 to a participating interest in a FIE if insufficient information is available to determine amounts required to be added or deducted in computing a taxpayer's income in respect of the interest under subsection 94.1(3).

If this information is not made available to the Minister of National Revenue on a timely basis on demand in respect of a participating interest in an entity, subsection 94.1(17) effectively provides that the rules in section 94.2, rather than the rules in section 94.1, apply in respect of the interest.

Similar rules apply in the event that insufficient information is provided to enable the appropriate calculation of a taxpayer's income arising from an election under paragraph 94.1(12)(*d*) to treat an affiliate as a controlled foreign affiliate. If insufficient information is provided in this context, the mark-to-market rules in section 94.2 will generally apply to the taxpayer if the affiliate is a FIE.

Foreign Investment Entities – Mark-to-market

ITA
94.2

New section 94.2 of the Act sets out new rules for the taxation of interests in FIEs where subsection 94.1 does not apply.

Except as otherwise indicated, section 94.2 applies to taxation years of investors that begin after 2001.

Definitions

ITA
94.2(1)

New subsection 94.2(1) of the Act provides that the definitions in subsection 94.1(1) apply for the purposes of section 94.2.

Subsection 94.2(1) also sets out the definitions "deferral amount" and "gross-up factor".

The deferral amount of a taxpayer generally represents the gain or loss (in the event that the interest was capital property, one half of the gain or loss) in respect of the interest accrued to the time when the interest first became subject to the rules in section 94.2. The expression "deferral amount " in respect of a participating interest in an entity applies principally for the purpose of determining the value of D in the formula set out in subsection 94.2(4). Subsection 94.2(4) generally provides for the recognition of a deferral amount in respect of a participating interest on the disposition of the interest. Because of subsection 94.2(2), identical participating interests are considered to be disposed of in the order in which they were acquired.

For participating interests in FIEs acquired after 2001, each deferral amount will be nil in the typical cases where the rules in section 94.2 apply to a taxpayer's interest in a FIE for the year in which the interests were acquired.

The deferral amount is calculated, in conjunction with subsections 94.2(5) and subsection 128.1(4), so that gains and losses accruing while a taxpayer is not resident in Canada are ignored for the purposes of section 94.2, except in the unusual case where an interest in a FIE is taxable Canadian property.

Additional rules affecting the calculation of the deferral amount are contained in subsections 94.2(6) and (13) to (17), as described in the commentary below.

The "gross-up factor" for a deferral amount is 1, except where the 1/2 factor is relevant in computing the deferral amount because the property is capital property. In the latter case, the "gross-up factor" is the reciprocal of the 1/2 factor (i.e., twice). For more detail on the

relevance of this definition, see the commentary on subsection 94.2(11).

Rules of application

ITA
94.2(2)

New subsection 94.2(2) of the Act provides rules of application for the purpose of section 94.2.

Paragraph 94.2(2)(*a*) provides that identical properties that were held and are disposed of by a taxpayer will be treated as having been disposed of in the order in which they were acquired by the taxpayer. For this purpose, paragraph 94.2(2)(*a*) makes it clear that the various acquisitions that are deemed to occur under the Act (e.g., section 47) are not to be taken into account. This measure is relevant primarily for the purpose of determining the amount to be added or deducted from a taxpayer's income under subsection 94.2(4), especially with reference to the "deferral amount" referred to in the description of D in paragraph 94.2(4)(*a*).

Paragraph 94.2(2)(*b*) provides that the rules in subsections 94.1(10), (11) (look-through rule for significant interests), and (13) to (15) (determination rules) also apply for the purposes of section 94.2.

Mark-to-market

ITA
94.2(3) and (4)

Subsection 94.2(3) of the Act sets out those circumstances where, subject to paragraph 94.2(5)(*b*), subsection 94.2(3) applies to a taxpayer in respect of a participating interest in a non-resident entity. For the mark-to-market regime in subsection 94.2(4) to apply for a taxation year, subsection 94.2(3) must apply for the year.

For subsection 94.2(3) to apply to a taxpayer throughout a taxation year in respect of a participating interest in a non-resident entity, either:

- Subsections 94.2(9) (tracked interests) or 94.2(10) (foreign insurance policies) must apply to the taxpayer for the year in respect of the interest; or

- Because of the application of subsection 94.1(4), the accrual regime under subsection 94.1(3) must not apply to the taxpayer in respect of the interest. (For details, see the commentary on subsections 94.1(2) and (4)).

Where subsection 94.2(3) applies to a participating interest in a FIE, paragraph 94.2(4)(*a*) requires a taxpayer to include in computing income as income from property, in respect of the interest, any positive amount resulting from the operation of the formula set out in paragraph 94.2(4)(*a*). Under paragraph 94.2(4)(*b*), the absolute value of any negative amount resulting from the operation of the same formula may be deducted in computing the taxpayer's income as a loss from property. (Note, however, that losses in respect of foreign insurance polices are denied because of subparagraph 94.2(4)(*b*)(i). Instead, as described below, the denied losses are carried forward to offset later income inclusions.)

The amount determined under the formula for a taxpayer's taxation year in respect of a participating interest in a FIE to be treated as an income or a loss from property is computed as follows:

- [A] ADD the proceeds of disposition in the year from any disposition by the taxpayer in the year of the interest (other than a disposition arising from the application of subsection 128.1(4) or 149(10), given that the value of B would take into account the fair market value of the interest at the time of such deemed dispositions);

- [B] ADD ,where the taxpayer held the interest at the end of the year, the fair market value of the interest at that time (determined before taking into account the FIE's liability in respect of any amount payable from the FIE in respect of the interest);

- [C] ADD the total payments received by the taxpayer in the year from the FIE, other than payments included in the value of A;

- [D] ADD, where the taxpayer so elects for a year during which the taxpayer did not dispose of the interest, any positive deferral amount in respect of the interest;

- [D] ADD, where the taxpayer disposed of the interest in the year and the election referred to above has not been previously made, the deferral amount in respect of the interest;[10]

- [E] SUBTRACT the cost of the interest on any acquisition in the year of the interest (disregarding acquisitions arising because of the application of subsection 128.1(4) or 149(10), given that these acquisitions are taken into account in the value of F);

- [F] SUBTRACT, where the taxpayer held the interest at the beginning of the year, the fair market value of the interest at the beginning of the year; and

- [G] SUBTRACT, in the case of a foreign insurance policy to which subsection 94.2(3) applies because of the operation of new subsection 94.2(10), any loss denied for the preceding year because of the operation of subparagraph 94.2(4)(*b*)(*i*).

Ignoring the descriptions of D and G, the formula in paragraph 94.2(4)(*a*) in effect determines the net increase or decrease in the fair market value of a taxpayer's participating interest in a FIE for a taxation year.

The value of D represents a taxpayer's accrued gain or loss when a participating interest first becomes subject to section 94.2. The amount of this accrued gain or loss (or one half of it, in the event so provided in the definition "deferral amount" in paragraph 94.2(1)(*b*)) is included in computing income under the description of D, but only for the taxation year in which the interest is disposed of unless the taxpayer elects for earlier recognition of a positive deferral amount. (An earlier recognition of a positive deferral amount may be beneficial for a taxpayer, particularly where section 94.3 applies.) Where the taxpayer is a trust, a disposition may occur as a consequence of the application of the 21-year deemed disposition rule. See, in this regard, new subsection 104(4.1).

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[10] The value of D will reduce the amount determined under the formula in the event that the deferral amount is a negative amount.

The example below illustrates the operation of subsection 94.2(4).

Example

1. *Leonard acquires a 1% interest in ABC Inc. in 1999 for $500. On December 31, 2000, it is capital property to Leonard. ABC Inc. is not a FIE in respect of the taxpayer at any time before 2004.*

2. *ABC Inc. becomes a FIE during 2004 and Leonard does not elect under subsection 94.1(4) to have the rules in section 94.1 apply. Leonard's interest in ABC Inc. does not qualify as an "exempt interest".*

3. *The fair market values of Leonard's participating interest at the beginning and at the end of 2004 are $800 and $1,000 respectively.*

4. *Leonard disposes of his shares just before the end of 2005 for $1,200. ABC Inc. does not make any distributions to Leonard during his period of ownership.*

Results

1. *No amount is included in Leonard's income for 2002 and 2003 under either section 94.1 or 94.2. For 2004, Leonard is required to include $200 in income under the formula in paragraph 94.2(4)(a).*

2. *The $200 inclusion is determined as follows:*

   - *"A" is nil, since no participating interest in ABC Inc. is disposed of in 2004,*

   - *"B" is $1,000, the fair market value of the participating interest at the end of 2004,*

   - *"C" is nil since no payments are received in 2004,*

   - *"D" is nil since no participating interest is disposed of in 2004 and no election was otherwise made,*

- *"E" is nil since no participating interest in ABC Inc. is acquired in 2004, and*

- *"F" is $800, the fair market value of the participating interest at the beginning of 2004.*

3. *Although Leonard's participating interest has appreciated by $500 since the time of its acquisition, only $200 is required to be included in income under section 94.2 for 2004.*

4. *For 2005, the amount included in income under subsection 94.2(4) is $350, computed as follows:*

   - *"A" is $1,200, the proceeds of disposition of the participating interest,*

   - *"B" is nil since Leonard does not own any participating interest in ABC Inc. at the end of 2005,*

   - *"C" is nil since no payments or distributions were received in 2005,*

   - *"D" is $150, the deferral amount in respect of the interest – the "deferral amount" is one half[11] of the amount by which $800 (the fair market value of the interest at the beginning of 2004 which is the first year in respect of which section 94.2 applies to the interest) exceeds $500 (the cost amount of the interest),*

   - *"E" is nil since no participating interest in ABC Inc. is acquired in 2005, and*

   - *"F" is $1,000, the fair market value of the participating interest at the beginning of 2005.*

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[11] *The one-half factor applies because Leonard's interest in ABC Inc. is capital property held by Leonard on June 22nd 2000.*

Non-resident Periods Excluded

ITA
94.2(5)

New subsection 94.2(5) of the Act provides special rules dealing with the application of section 94.2 for a taxation year to persons who are not resident in Canada throughout the year.

Under paragraph 94.2(5)(*a*), the amounts determined under section 94.2 are generally determined as if the taxation year of the taxpayer excludes the period in the year during which the taxpayer is not resident in Canada. This rule, in conjunction with section 128.1, generally ensures that the increases and decreases in fair market values that are relevant in determining income inclusions and deductions under section 94.2 are the increases and decreases occurring while the taxpayer is resident in Canada. However, this rule does not affect the calculation of the taxpayer's deferral amount: paragraph 94.2(1)(*b*) (in conjunction with subsection 128.1(1)) already ensures that gains or losses accruing prior to becoming resident in Canada are not taken into account for the purposes of computing a taxpayer's deferral amount in respect of a participating interest in a FIE, except in the unusual case where the FIE interest is taxable Canadian property.

Paragraph 94.2(5)(*a*) also ensures that subsection 94.2(4) does not apply to a taxpayer for a taxation year throughout which the taxpayer is not resident in Canada.

Under paragraph 94.2(5)(*b*), subsection 94.2(3) generally does not apply to a taxpayer at a particular time if the taxpayer is not resident in Canada at the particular time. This has relevance for the purposes of a number of new provisions, including subparagraph 39(1)(*a*)(ii.3). This subparagraph has the effect of excluding, from a taxpayer's capital property, a property in respect of which subsection 94.2(3) applies and is intended to ensure that there is no double taxation with respect to the same economic gain. Paragraph 94.2(5)(*b*) thus ensures that a non-resident taxpayer cannot claim that a taxable Canadian property consisting of a FIE interest is not capital property on the basis of subparagraph 39(1)(*a*)(ii.3). (Note: non-resident taxpayers are generally subject to tax on taxable capital gains from their dispositions of taxable Canadian properties.)

Paragraph 94.2(5)(*c*) applies in the unusual case where an individual changes his or her Canadian residence status more than once in the same calendar year. For example, an individual might leave Canada near the beginning of a calendar year but return later in the same year. In the event that such an individual is considered not to reside in Canada during a period in the calendar year, the individual's period of non-residence would be included within the individual's taxation year and the rule in paragraph 94.2(5)(*a*) would have no effect. In order to not tax gains accrued while an individual was non-resident and to not provide relief for losses accrued during the same period, paragraph 94.2(5)(*c*) provides that:

- for the purposes of section 114, the individual's income or loss from the individual's period of non-residence is determined without reference to section 94.2, and

- in computing the individual's taxable income under section 114,

  - there is to be deducted the increase in the fair market value of an interest in a FIE to which subsection 94.2(4) applies during the non-resident period (this fair market value appreciation would be reflected in the amount determined under subsection 94.2(4) in computing the taxpayer's income), and

  - there is to be added the decline in the fair market value of an interest in a FIE to which subsection 94.2(4) applies that accrued during the non-resident period (this fair market value decline would be reflected in the amount determined under subsection 94.2(4) in computing the taxpayer's income).

The example below illustrates the operation of paragraph 94.2(5)(*c*).

Example

Bernard emigrates from Canada on February 1, 2002 in order to start permanent employment elsewhere. Due to unexpected changes in circumstances, he returns to Canada on December 1, 2002. Bernard owns an interest in a FIE to which section 94.2 applies. The fair market value of the interest in 2002 increases from $100 (January 1, 2002), to $105 (February 1, 2002), to $108 (December 1, 2002) and to $107 (December 31, 2002). It is

assumed that Bernard establishes that he did not reside in Canada from February 1, 2002 to December 1, 2002.

Results

1. *Under section 94.2(4), the amount included in computing Bernard's income for 2002 is equal to $7 (B = 107, F = 100).*

2. *Paragraph 94.2(5)(c) permits a deduction for the purposes of paragraph 114(a) equal to $3 (i.e., $108 - $105) equal to the appreciation in the fair market value of the interest while Bernard was not resident in Canada. As a consequence, Bernard's taxable income in respect of the FIE interest for 2002 is $4 (i.e., $7 minus $3).*

Foreign Partnerships – Change of Residence of Member

ITA
94.2(6) to (8)

New subsections 94.2(6) to (8) of the Act provide special rules for partnerships having non-resident members. These subsections are analogous to rules in existing subsections 96(8) and (9) and are designed, in general terms, to prevent partnership losses that accrue while no partnership member is resident in Canada from being used in Canada. A further rule for partnership members is set out in new subsection 96(1.9).

More specifically, subsection 94.2(6) applies where a partnership begins to have members who reside in Canada. Under subsection 94.2(7), a corresponding rule applies in a similar fashion where a partnership ceases to have members who reside in Canada. In either case, for the purposes of determining amounts under section 94.2 portions of the fiscal period of the partnership in which no member is resident in Canada will generally be disregarded.

Where subsection 94.2(6) applies to a partnership at any time, the deferral amount for a FIE interest held by the partnership immediately before that time is computed with reference to the fair market value and the cost amount of the interest. However, if a negative deferral amount is otherwise determined with respect to the interest, the deferral amount is deemed to be nil.

As a consequence of subsections 94.2(6) and (7), amounts added or deductible under subsection 94.2(4) for a partnership in respect of a FIE interest will generally reflect increases or decreases in fair market value while the partnership has members resident in Canada. However, once the interest is disposed of, an amount reflecting gains accruing before any member became resident in Canada will be recognized because of the application of subsection 94.2(4).

Subsection 94.2(8) contains an anti-avoidance rule, which is aimed at preventing the insertion of nominal Canadian resident partners for tax planning purposes. This rule is parallel to the rule in existing subsection 96(9).

Subsection 94.2(8) also contains a "look-through" rule. It allows for the "look-through" of one or more tiers of partnerships for the purposes of determining whether a person is a member of a partnership.

Tracked Interests

ITA
94.2(9)

New subsection 94.2(9) of the Act is an anti-avoidance rule intended to prevent the circumvention of sections 94.1 and 94.2 through the creation of "tracked interests" in entities that are not FIEs or through the creation of an interest in a FIE that would otherwise be an "exempt interest". Where subsection 94.2(9) applies with regard to a "tracked interest" for a taxation year, the mark-to-market regime in section 94.2 applies to a taxpayer for that year.

A participating interest held by a taxpayer in a particular non-resident entity in a taxation year is a "tracked interest" in the particular entity for a particular taxation year of the taxpayer where:

- a taxation year of the particular entity ended at or before the end of the particular year (the latest of which taxation years is referred to below as the "specified year");[12]

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[12] Paragraph 94.2(9)(*b*).

- the taxpayer is not an exempt taxpayer for the particular year (see commentary on definition "exempt taxpayer" in subsection 94.1(1));[13]

- the participating interest is not a "mark-to-market property" held by a "financial institution" (both within the meanings assigned by subsection 142.2(1));[14]

- the entitlement to receive payments from the particular entity, directly or indirectly, in respect of the participating interest (or its fair market value) is determined, directly or indirectly, primarily by reference to production, revenue, profit or cash flow from, the fair market value or the use of, or any other similar criterion in respect of, a property or group of properties (referred to below as the "tracked properties");[15]

- at the end of the specified year, all or substantially all of the fair market value of the tracked properties cannot be attributed, directly or indirectly, to the fair market value of shares of the capital stock of a foreign affiliate of the taxpayer that:

  - if held by the taxpayer, would be qualifying interests in the foreign affiliate and participating interests in a qualifying entity; and

  - are not shares that are tracked property in respect of a participating interest in a non-resident entity held by another taxpayer or entity that is not related to the taxpayer[16];

- at the end of the specified year, the tracked properties are not all of the properties owned by the particular entity (ignoring the deemed ownership rule in subsection 94.1(10))[17] or the tracked properties include properties that would not be owned by the entity (ignoring the deemed ownership rule in subsection 94.1(10)) and are not all of the properties that would be owned by the entity taking into account the deemed ownership rule subsection 94.1(10); and

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[13] Paragraph 94.2(9)(*c*).
[14] Paragraph 94.2(9)(*d*).
[15] Paragraph 94.2(9)(*e*).
[16] Paragraph 94.2(9)(*f*).
[17] Paragraph 94.2(9)(*g*).

- at the end of the specified year, is either

  - in general terms, the total carrying value of investment property owned by the entity that is tracked property is greater than one-half of the total carrying value of all tracked property owned by the entity,[18] or

  - the entity (or any other non-resident entity) owns an investment property (other than a tracked property owned by the entity) and it is reasonable to conclude that the production, revenue, profit or cash flow from that investment property, the increase in the fair market value of that investment property or any other return based on a similar criterion is intended to enable the entity to satisfy all or part of an entitlement in respect of a tracked interest[19].

More specifically, for the purpose of determining the above totals, the carrying value of investment property owned by an entity included in the tracked properties as of the end of the specified year is determined as follows:

- ADD the carrying value of investment property included in the tracked properties and owned by the particular entity (determined with reference to the definition "investment property" and the deemed ownership rule in subsection 94.1(10)); and

- ADD the carrying value (determined without reference to subsection 94.1(10)) of specified investment property owned by the particular entity and included in the tracked properties. The investment property so specified is the property that would otherwise have a deemed cost of nil under paragraph 94.1(10)(*a*) and that is either a participating interest in a FIE or indebtedness owing by a FIE. (The specified investment property represents debt or equity interests in entities in which the particular entity has a "significant interest", as defined by subsection 94.1(11)).

For the same purpose, the total carrying value of the total property included in the tracked properties is determined as of the end of the

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[18] Paragraph 94.2(9)(*h*)(i).
[19] Paragraph 94.2(9)(*h*)(ii).

specified taxation year of the particular entity in the following manner:

- ADD the carrying value of each property owned by the particular entity that is included in the tracked properties. (This determination is made with reference to the look-through rule in subsection 94.1(10)); and

- ADD the carrying value (determined without reference to subsection 94.1(10)) of specified investment property referred to above.

It should be noted that tracked properties can include any property, whether or not owned by a taxpayer or a related group of which the taxpayer is a part. For example, if the fair market value of shares issued by a non-resident entity is tracked to the world-wide price of gold bullion, the tracked properties in question would be the world-wide supply of gold bullion. Whether subsection 94.2(9) applies or not in this case would typically depend on whether subparagraph 94.2(9)(*f*)(ii) applies to the non-resident entity.

It should also be noted that there is no exemption under subsection 94.2(9) with regard to an "exempt interest" (as defined in subsection 94.1(1)) in a non-resident entity. Thus, the mark-to-market rules can apply to a taxpayer in respect of shares of the capital stock of a controlled foreign affiliate of the taxpayer.

Treatment of Foreign Insurance Policies

ITA
94.2(10)

New subsection 94.2(10) of the Act sets out the treatment under section 94.2 of an interest in a foreign insurance policy. It applies for taxation years that begin after 2002. For this purpose, a foreign insurance policy is one that is not issued by an insurer in the course of carrying on business in Canada the income from which is subject to tax under Part I.

Paragraphs 94.2(10)(*a*) and (*b*) generally provide that, where a taxpayer (other than an exempt taxpayer) holds an interest in such an insurance policy, for the purposes of subsections 94.2(3) and (4) (and

a corresponding foreign property reporting rule in subsection 233.3(1)) the particular interest is deemed to be a participating interest in a non-resident entity to which the mark-to-market rules in subsection 94.2(4) apply. However, the mark-to-market regime under subsection 94.2(4) applies differently to insurance policies in two respects. First, no deferral amount is calculated with regard to insurance policies. Second, losses are not deductible, but instead can be used to offset future income amounts otherwise arising under subsection 94.2(4). (As to the treatment of losses, see the commentary on subsection 94.2(4)). Those paragraphs also provide that, where the mark-to-market rules apply to an insurance policy, the other rules in the Act with regard to the taxation of insurance products do not apply.

Paragraph 94.2(10)(*c*) provides that paragraphs 94.2(10)(*a*) and (*b*) do not apply to a taxpayer in respect of an insurance policy in the following situations:

- The taxpayer is an individual and the interest in the policy was acquired more than five years before the taxpayer became resident in Canada. However, this exception does not apply if premiums in excess of the level originally contemplated under the policy have been paid within 5 years of the policyholder becoming resident in Canada or while the policyholder was resident in Canada.

- Under the terms and conditions of the policy, the policyholder is entitled to receive only benefits payable as a consequence of the occurrence of the risks insured under the policy and a return of premiums previously paid upon the surrender, cancellation or termination of the policy.

- The taxpayer can establish to the satisfaction of the Minister of National Revenue that an appropriate amount of income has been included in the taxpayer's income under section 12.2 in respect of the policy or that the interest in the policy is an interest in an exempt policy for the purpose of that section.

In the event that new paragraphs 94.2(10)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy in a particular year but apply to that taxpayer in respect of that interest in the following year, paragraph 94.2(10)(*d*) provides that the taxpayer is deemed to have acquired the interest in the insurance policy, at its

fair market value at the end of the particular year (determined with reference to paragraph 94.2(10)(*f*)), immediately after the beginning of the following taxation year.

In the event that paragraphs 94.2(10)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy for a taxation year but did apply in the preceding taxation year, paragraph 94.2(10)(*e*) provides that the taxpayer is deemed to have disposed of the interest in the insurance policy immediately before the end of the preceding taxation year for proceeds equal to its fair market value at that time.

Paragraph 94.2(10)(*f*) provides that the fair market value of an interest in an insurance policy and amounts of proceeds of disposition of an interest in an insurance policy and payments in respect of interests in insurance policy are determined without reference to benefits paid, payable or anticipated to be payable under the policy only as a consequence of the occurrence of the risks insured under the policy.

Paragraph 94.2(10)(*g*) provides that, where a taxpayer makes a premium or a policy loan payment in respect of an insurance policy in a taxation year, an interest in the insurance policy is deemed to have been acquired in the year. The cost of the interest is the total of the premiums paid and the payments of the principal amount of policy loans to the extent the loans were included in proceeds of disposition of the interest in prior years.

Paragraph 94.2(10)(*h*) provides rules permitting additions to the deemed cost of an interest in a policy otherwise determined for a year where the actual costs exceed the fair market value of interest at the beginning of the first taxation year in which subsection 94.2(4) applies to the taxpayer in respect of these interests. The amount that may be added is the amount, if any, by which the qualifying premiums paid at or before that time in respect of the interest in the policy exceeds the fair market value of the interest at that time.

Paragraph 94(10)(*i*) provides rules adding to a taxpayer's proceeds of disposition otherwise determined of an interest in an insurance policy for the year in which it is disposed of, the amount by which the fair market value of the interest at the beginning of the first taxation year

in which subsection 94.2(4) applies to the taxpayer in respect of the interest exceeds the cost of the interest at that time.

In the event that paragraphs 94.2(10)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy for one taxation year and did apply in the preceding year, paragraph 94.2(10)(*j*) deems the taxpayer to have acquired the interest at the beginning of the taxation year and provides that the cost of the interest is equal to the amount if any by which is the total of the fair market value and the amount that would be determined under subparagraph 94.2(4)(*b*)(ii) in respect of the interest at the end of the preceding taxation year if that subparagraph applied to the interest exceeds the amount determined under subparagraph 94.2(4)(*b*)(*i*) in respect of the interest in respect of the taxpayer.

Example

Assume that David, a long-term resident of Canada, pays premiums of $10,000 to an offshore insurer for a life insurance policy in 2000. The policy's fair market value is $9,000 and $10,700 at the end of 2003 and 2004 (respectively).

Results

1. *For 2003, no income amount is determined under paragraph 94.2(4)(a) because the cost of the policy exceeds the fair market value at the end of 2003. The cost to David of the policy is deemed to be $10,000 ($9000 + $1000).*

2. *The loss for the year 2003 is $1000. ($9000 – $10,000). No claim in respect of the loss is permitted under paragraph 94.2(4)(b) of the Act. The amount of the denied loss is equal to $1,000 and is included under G in the formula in paragraph 94.2(4)(a) in year 2004.*

3. *For 2004, the amount included in income under paragraph 94.2(4)(a) is $700 (= $10,700 ("B"), minus $9,000 ("F"), minus $1,000 ("G")).*

It is possible that the cash surrender value of a policy may be less than its fair market value.

Change of Status of Entity

ITA
94.2(11)

New subsection 94.2(11) of the Act sets out rules that apply where a taxpayer holding a participating interest in a non-resident entity was subject to subsection 94.2(4) for a taxation year but is not subject, in respect of the interest, to subsection 94.2(4) for the following taxation year (otherwise than because the taxpayer ceased to reside in Canada or became an "exempt taxpayer", as defined in subsection 94.1(1)).

Where subsection 94.2(11) applies, the taxpayer is deemed to have acquired the particular interest at the beginning of the following taxation year at a cost equal to the fair market value of the particular interest at that time.

This subsection could apply, for example, where a taxpayer holds a share of the capital stock of a non-resident corporation and the share is not an "exempt interest", as defined in subsection 94.1(1). Assume that the taxpayer made no election under subsection 94.1(4) for section 94.1 to apply. If the entity subsequently becomes a controlled foreign affiliate of the taxpayer, subsection 94.2(4) would cease to apply.

Since the taxpayer is deemed to have acquired the property at its fair market value at the beginning of the following year, all increases and decreases in the value of the interest from the time of its acquisition are reflected in the taxpayer's cost of the interest for tax purposes. However, only the gain or loss accruing while it was subject to subsection 94.2(4) has been brought into income. The gain or loss in value for the period from the time of acquisition to the time it became subject to subsection 94.2(4) has not been taken into consideration for tax purposes.

Accordingly, paragraph 94.2(10)(*b*) provides for a negative or positive adjustment to the adjusted cost base (ACB) of a participating interest held as capital property. Any positive "deferral amount" (as defined in subsection 94.2(1)) in respect of the interest is deducted in computing the ACB of the interest, but the deduction is grossed-up by a factor of two in the event that the deferral amount was calculated with reference to one-half of the accrued gains. The ACB

deduction does not, however, apply in the event that a positive deferral amount has already been taken into account because of an election under the description of D in paragraph 94.2(4)(*a*). The absolute value of any negative deferral amount (or twice the amount if the 1/2 factor was used in computing the negative deferral amount) is added in computing the ACB of the interest. Where capital property is not involved, a corresponding decrease or increase in cost (rather than adjusted cost basis) is provided under paragraph 94.2(11)(*c*). To the extent that the decrease would otherwise result in a negative cost, the decrease is brought into the taxpayer's income under paragraph 94.2(11)(*c*).

Cost of Participating Interest

ITA
94.2(12)

New subsection 94.2(12) of the Act provides a rule for determining the cost at a particular time of a participating interest in an entity for a taxation year in the event that the interest is disposed of by the taxpayer in the year.

The cost to the taxpayer immediately before the disposition of the property is deemed to be its fair market value at the beginning of the taxpayer's taxation year. In the event that the property was not held by the taxpayer at that time, its cost immediately before the disposition is its cost determined without reference to subsections 94.2(4) and (12). In identifying property for these purposes, identical properties of a taxpayer are considered to be disposed of on a "first in, first out" basis, as a consequence of the application of subsection 94.2(2).

Under new paragraph (*c*.2) of the definition "cost amount" in subsection 248(1), the cost determined at a particular time for a property under subsection 94.2 (12) is also the "cost amount" of the property at the particular time.

Deferral Amount where Same Interest Reacquired

ITA
94.2(13)

New subsection 94.2(13) of the Act generally provides that a "deferral amount" in respect of a property of a taxpayer is deemed to be nil, after the property has been disposed of by the taxpayer at a time when the mark-to-market rules in subsection 94.2(4) applied to the property. This is of relevance to property that is reacquired by a taxpayer. However, subsection 94.2(13) is subject to the rules in subsections 94.2(14) to (17).

It should be noted that identical properties of a taxpayer are considered to be disposed of on a "first in, first out" basis as a consequence of the application of subsection 94.2(2).

Fresh-start re Change of Status of Entity

ITA
94.2(14)

New subsection 94.2(14) of the Act applies where a taxpayer's participating interest in an entity was initially subject to the rules in subsection 94.2(4) and ceases to be subject to those rules (otherwise than because of the taxpayer having become an "exempt taxpayer"). For example, subsection 94.2(14) could apply where an entity ceases to be a FIE.

In these circumstances, the deferral amount in respect of the participating interest is determined without reference to the past application of subsections 94.2(4) and (13). This rule is relevant only in the event that the same participating interest of the taxpayer again becomes subject to the rules in subsection 94.2(4).

Parallel "fresh-start" rules are contained in subsection 94.2(15) and (16). All of these "fresh-start" rules are expected to be only rarely involved, given that more than one change in status of an investment or a taxpayer is required for the rules to become relevant. For further detail on the "deferral amount" defined in subsection 94.2(1), see the commentary on that definition.

Fresh-start after Emigration of Taxpayer

ITA
94.2(15)

New subsection 94.2(15) of the Act affects the calculation of the "deferral amount" in respect of a participating interest in an entity for a taxpayer who has ceased to reside in Canada. It is relevant in the event that, at a subsequent time, the taxpayer becomes resident in Canada again.

In these circumstances, the deferral amounts in respect of the taxpayer's FIE interests are determined without reference to the past application of subsections 94.2(4) and (13).

For further context, see the commentary above on the related fresh-start rule in subsection 94.2(14).

Fresh-start re Change of Status of Tax-exempt Entity

ITA
94.2(16)

New subsection 94.2(16) of the Act affects the calculation of the "deferral amount" in respect of an interest in an entity for a taxpayer that initially was not an "exempt taxpayer" under paragraph (*b*) of that definition and then subsequently both obtains and loses that status.

In these circumstances, the deferral amounts in respect of the FIE interests of the taxpayer are determined without reference to the past application of subsections 94.2(4) and (13).

For further context, see the commentary on the related fresh-start rule in subsection 94.2(14). In addition, it should be noted that amended subsection 149(10) applies to changes of tax-exempt status for taxpayers that are corporations. Where subsection 149(10) applies, the rules in subsection 94.2(16) do not apply.

Superficial Dispositions

ITA
94.2(17)

New subsection 94.2(17) of the Act applies where a taxpayer disposes of a participating interest in an entity in respect of which a negative amount is determined under the description of D in the formula in subsection 94.2(4). This would be the case where there is a negative deferral amount associated with the interest. In these circumstances, the deferral amount is instead generally deemed to be nil if, during the period beginning 30 days before the disposition and ending 30 days after the disposition, identical property is acquired by the taxpayer or certain related persons.

Subsection 94.2(17) operates in a manner similar to the "superficial loss" rules for capital properties and is intended to prevent the premature realization of losses in respect of a property in which a taxpayer effectively retains an economic interest. "Superficial loss" has the same meaning as assigned in section 54, except that the definition for the purposes of subsection 94.2(17) does not contain the exception for transactions covered by subsection 40(3.4).

Property substituted for the particular property is, in these circumstances, considered to have the deferral amount associated with the property disposed of.

Determination of Capital Dividend Account

ITA
94.2(18)

New subsection 94.2(18) provides rules that deem a positive or negative deferral amount in respect of a disposition of what would, but for sections 94.1 and 94.2, be a capital property to be a taxable capital gain or an allowable capital loss, as the case may be, and twice such an amount to be a capital gain or capital loss of the corporation, as the case may be, for the purposes of computing the capital dividend account of the corporation. This rule ensures that 1/2 of a capital gain or a capital loss that is attributable to a deferral amount is reflected in the capital dividend account of a corporation.

Non-application of Subsection (4)

ITA
94.2(19)

New subsection 94.2(19) provides a special rule that requires a taxpayer to report, in certain circumstances, amounts determined under subsection 94.2(4) for a particular year in respect of a participating interest in a foreign investment entity as capital gains and losses rather than as income from property.

This rule applies where all or substantially all the amount required to be added or deducted in computing the taxpayer's income for the particular year under subsection 94.2(4) in respect of a participating interest can be attributed to

- capital gains and losses of the foreign investment entity from dispositions of capital property of the foreign investment entity,

- increases or decreases in the fair market value of capital property of the foreign investment entity during the year, or

- a combination of such gains and losses and increase or decreases in fair market value.

In such a case, no amount is included or deducted in computing the taxpayer's income for the year in respect of the participating interest under subsection 94.2(4).

Deemed Capital gain or Loss

ITA
94.2(20)

New subsection 94.2(20) provides that where new subsection 94.2(19) applies to a taxpayer's interest in a FIE for a taxation year, the taxpayer is treated as having

- realized capital gains in the year equal to the total of the positive amount determined under subsection 94.2(4) in respect of the taxpayer in respect of the participating interest plus or minus the positive or negative deferral amount included in "D" in the formula

in subsection 94.2(4) in respect of the taxpayer in respect of the participating interest for the year, or

- realized capital losses in the year equal to the total of the negative amount determined under subsection 94.2(4) in respect of the taxpayer in respect of the participating interest plus or minus the negative or positive deferral amount included in "D" in the formula in subsection 94.2(4) in respect of the taxpayer in respect of the participating interest for the year.

Prevention of Double Taxation

ITA
94.3
New subsection 94.3 provides rules to eliminate double taxation of income where a FIE, to which section 94.1 or 94.2 has applied, distributes income to a holder of an interest in the FIE.

Where a taxpayer resident in Canada has received a payment (a dividend, for example) in respect of a participating interest in an entity held by the taxpayer (otherwise than as consideration for the disposition of the interest), new section 94.3 of the Act permits a deduction designed to offset any net income inclusion resulting from the payment. The permitted deduction for a taxation year is equal to the lesser of:

- the amount, if any, by which the total of the amounts included (otherwise than because of subsection 94.2(4)) in computing the taxpayer's income for the year or a preceding taxation year in respect of payments from the entity in the year or a preceding year, exceeds amounts deductible under subsection 91(5) or section 113 in respect of those payments, and

- the amount, if any, by which the total of

  - the amounts included (or that, but for subsection 94.2(19), would have been included) under subsections 94.1(3) or 94.2(4) in computing the taxpayer's income for the taxation year or a preceding taxation year, and

- the amount required by subparagraph 94.1(9)(*a*)(ii) to be added to the adjusted cost base of the participating interest at the end of the taxation year or a preceding taxation year,

exceeds the total of

- the amounts deducted (or that, but for subsection 94.2(19), would have been deducted) under subsection 94.1(3) or 94.1(4) in computing the taxpayer's income for the taxation year or a preceding taxation year, and

- the amount required by subparagraph 94.1(9)(*b*)(ii) to be deducted from the adjusted cost base of the participating interest at the end of the taxation year or a preceding taxation year.

In the event that the participating interest is capital property, the amount deducted from income under subsection 94.3(2) in respect of the interest is also required to be deducted in computing the adjusted cost base of the interest. Note that this deduction is not of relevance to property to which the mark-to-market rules in section 94.2 apply, given that such property will not be capital property as a consequence of the application of subparagraph 39(1)(*a*)(ii.3) and section 94.2.

Section 94.3 also allows income inclusions in respect of amounts payable (for example, amounts payable by a FIE that is a trust) to be similarly treated.

The example below illustrates the operation of section 94.3.

Example

1. *A taxpayer resident in Canada, Canco, purchases a 20% interest in Foreignco, a non-resident corporation. Foreignco is a FIE. Participating interests in Foreignco do not qualify as "exempt interests". Both Canco and Foreignco have taxation years that coincide with calendar years. Canco makes an election under subsection 94.1(4) to have section 94.1 apply.*

2. *Canco's income allocation in respect of its participating interest in Foreignco for 2002 is $100,000, which is added in computing Canco's income under subsection 94.1(3). This is partially offset by a specified tax allocation of $30,000.*

Foreignco pays a dividend of $50,000 to Canco in 2002. Canco includes the dividend in income pursuant to section 90 and claims a deduction of $20,000 in computing its taxable income pursuant to subsection 113(1).

Results

1. *Canco's deduction from income under section 94.3 is equal to $30,000, being the lesser of the net income inclusion as a result of the payment (= $50,000 minus $20,000) and the amount of the net income inclusions under subsection 94.1(3) ($100,000 minus $30,000).*

2. *The result would generally be the same if the $50,000 dividend were instead paid in a subsequent year.*

Clause 12

Foreign Affiliates

ITA
95

Section 95 of the Act defines a number of terms and provides certain rules relating to the taxation of resident shareholders of foreign affiliates.

Definitions

ITA
95(1)

Subsection 95(1) of the Act sets out definitions that are relevant for the purposes of sections 90 to 95.

Subsection 95(1) is amended so that these definitions do not apply for the purposes of sections 94 to 94.3, except where the definition applies for the purposes of the Act as a whole because of subsection 248(1). This amendment applies to taxation years that begin after 2001.

As set out below, various definitions in subsection 95(1) are also being amended.

"controlled foreign affiliate"

The income for a taxation year of a taxpayer resident in Canada includes, pursuant to subsection 91(1) of the Act, a specified percentage of the foreign accrual property income (FAPI) of any controlled foreign affiliate of the taxpayer. In order to eliminate overlap between the FAPI rules and the rules for foreign investment entities in sections 94.1 and 94.2, the latter rules do not apply in respect of a taxpayer's interest in a controlled foreign affiliate of a taxpayer resident in Canada. An election is provided under new subsection 94.1(12) under which a foreign affiliate of a taxpayer can be treated as controlled foreign affiliate.

The definition "controlled foreign affiliate" is amended to make a cross-reference to foreign affiliates that are deemed by subsection 94.1(12) to be controlled foreign affiliates. Given the wording in subsection 94.1(12), this reference is not technically necessary but is meant to serve as a useful clarification of the potential application of subsection 94.1(12).

This amendment applies after 2001.

"foreign accrual property income"

The FAPI of a controlled foreign affiliate of a taxpayer resident in Canada is allocated to the taxpayer in accordance with subsection 91(1) of the Act. Under its definition in subsection 95(1), FAPI includes certain amounts that would be included in the affiliate's income under existing subsection 94.1(1) if that subsection were read in the manner specified in the description of C of the definition.

Existing section 94.1 is repealed. Accordingly, the description of C in the definition "foreign accrual property income" is also repealed. There are, however, special rules in new paragraph 95(2)(*g*.2) with regard to the application of sections 94.1 to 94.3 for the purposes of computing FAPI.

This amendment applies to taxation years of controlled foreign affiliates that begin after 2001.

"investment business"

"Investment business" of a foreign affiliate means a business carried on by the foreign affiliate the principal purpose of which is to derive income from property. However, an arm's length business carried on by a foreign bank, trust company, credit union, insurance corporation or securities trader is excluded from the definition "investment business" where the business is regulated in the country in which the business is principally carried on and a 5-employee test is satisfied.

The definition is amended to include, in subparagraph (*a*)(i), a business carried on by a foreign affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of the country in which the affiliate was formed, organized, continued or exists and is governed and of each country in which the business is carried on,

- of the country in which the business is principally carried on, or

- where the affiliate is controlled by a corporation, of the country in which the controlling corporation is formed, organized, continued or exists and is governed, where those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union.

"relevant tax factor"

The existing definition "relevant tax factor" provides that the "relevant tax factor" for an individual is 2 and for a corporation is the reciprocal of the basic corporate tax rate (i.e., 1/.38, or 2.63).

Under new section 94.1, the "relevant tax factor" is relevant in determining the extent to which relief is provided for investors in foreign investment entities in respect of income or profits taxes payable by those entities. (See, in this regard, subsection 94.1(8).) Partnerships may hold interests in such entities, in which case it may become necessary to compute a relevant tax factor in respect of a partnership.

The definition "relevant tax factor" is amended so that the relevant tax factor for a partnership is 2, except where its members consist entirely of corporations resident in Canada and non-resident persons. In the latter case, the "relevant tax factor" is 2.63.

This amendment applies after 2001.

Foreign Investment Entities

ITA
95(2)

Subsection 95(2) of the Act provides rules for determining the income of a foreign affiliate of a taxpayer resident in Canada. These rules apply for the purposes of sections 90 to 95.

The rules in new paragraph 95(2)(*g*.3) set out the manner in which sections 94.1 to 94.3 apply for the purpose of computing income from property that is to be included in computing the FAPI of a particular foreign affiliate of a Canadian taxpayer for a particular taxation year of the affiliate. They are to be applied as if

- The particular affiliate was a taxpayer resident in Canada throughout the particular year (other than for the purposes of determining if the particular affiliate is a foreign affiliate of a taxpayer, if the particular affiliate is a foreign investment entity or if a particular interest in the foreign affiliate is an exempt interest in a foreign investment entity);

- The exemption in the definition "exempt interest" for controlled foreign affiliates is treated as if it referred only to controlled foreign affiliates of the Canadian taxpayer (not of the particular affiliate);[20]

- The Canadian taxpayer, rather than the particular affiliate, claims deductions relevant in determining the particular affiliate's income allocation or loss allocation in respect of a participating interest in a foreign investment entity held by the particular affiliate.[21] These claims are only relevant for taxation years of the particular affiliate

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[20] Subparagraph 95(2)(*g*.3)(ii).
[21] Subparagraph 95(2)(*g*.3)(iii) and (iv).

that begin after 2001, once the particular affiliate holds an interest in the foreign investment entity and is a controlled foreign affiliate of the Canadian taxpayer;[22]

- The exclusion of dividends under paragraph 94.1(5)A(*g*) applies only where the Canadian taxpayer is resident in Canada, in connection with dividends received by the particular affiliate from foreign affiliates of the Canadian taxpayer (not of the particular affiliate) in which the Canadian taxpayer (not the particular affiliate) has a qualifying interest (determined under paragraph 95(2)(*m*));[23]

- In the event that the particular affiliate has a participating interest in a particular FIE and the particular entity has a participating interest in another non-resident entity, the application of sections 94.1 and 94.2 to the particular entity is determined as if the exclusion from the application of those sections for controlled foreign affiliates referred to in paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1) were for controlled foreign affiliates of the Canadian taxpayer (not controlled foreign affiliates of the particular entity).[24] This rule applies instead of the rule in paragraph 94.1(5)A(*i*);[25]

- The Canadian taxpayer (rather than the particular affiliate) is permitted to make an election under subsection 94.1(4) or subparagraph (i) of the description of D in paragraph 94.2(4)(*a*) in connection with the particular affiliate's participating interests in foreign investment entities;[26]

- The particular affiliate's deferral amount determined under paragraph 94.2(1)(*b*) does not include the portion of the amount that can reasonably be considered to have accrued during the period that the particular affiliate was not a foreign affiliate of the Canadian taxpayer and certain other specified persons;[27]

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[22] Clause 95(2)(*g*.3)(viii)(B).
[23] Subparagraphs 95(2)(*g*.3)(v) and (vi).
[24] Clause 95(2)(*g*.3)(viii)(A).
[25] Subparagraph 95(2)(*g*.3)(vii).
[26] Subparagraph 95(2)(*g*.3)(ix).
[27] Subparagraph 95(2)(*g*.3)(x).

- The reference in subsection 94.2(18) to the expression "in computing the capital dividend account of the corporation" were read in respect of the affiliate as a reference to the expression "in computing the amount prescribed to be the particular affiliate's exempt surplus and taxable surplus in respect of the taxpayer"; and

- Subsection 94.1(4) were read without reference to paragraph 94.1(4)(*e*) so that a controlled foreign affiliate that is a foreign investment entity can use the accrual rules in subsection 94.1.

This amendment applies to taxation years that begin after 2001.

Paragraph 95(2)(*l*) of the Act includes in a foreign affiliate's income from property its income derived from a business the principal purpose of which is to derive income from trading or dealing in certain indebtedness (including the earning of interest on such indebtedness). Where the business of the affiliate of a taxpayer is described in subparagraph 95(2)(*l*)(iii) and the taxpayer is described in subparagraph 95(2)(*l*)(iv), paragraph 95(2)(*l*) does not apply to the affiliate.

Subparagraph 95(2)(*l*)(iii) is amended to refer to a business carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation, or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of the country in which the affiliate was formed, organized, continued or exists and is governed and of each country in which the business was carried on,

- of the country in which the business is principally carried on, or

- if the affiliate is controlled by a non-resident corporation, of the country under whose laws the controlling corporation was formed , organized, continued or exists and is governed, if those laws are recognized under the laws of the country in which the business is principally carried on and all those countries are members of the European Union.

Paragraph 95(2)(*a*.1) includes certain income in a foreign affiliate's income from a business other than an active business. Subsection 95(2.4) provides that paragraph 95(2)(*a*.1) does not apply to a foreign

affiliate of a taxpayer in respect of income if it meets the requirements of paragraphs (*a*) and (*b*) of that subsection.

Subparagraph 95(2.4)(*a*) is amended to refer to income derived by the affiliate in the course of a business that is conducted by it principally with persons with whom it deals at arm's length and that is carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation, or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of the country in which the affiliate was formed , organized, continued or exists and is governed and in each country in which the business was carried on,

- of the country in which the business is principally carried on, or

- if the affiliate is controlled by a non-resident corporation, of the country under whose laws the controlling corporation was formed , organized, continued or exists and is governed, if those laws are recognized under the laws of the country in which the business is principally carried on and all those countries are members of the European Union.

Clause 13

Partnerships and their Members

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

Application of sections 94.1 and 94.2

ITA
96(1.9)

New subsection 96(1.9) of the Act is relevant where an "exempt taxpayer" (in general, an individual who has been resident in Canada for fewer than 60 months) is a member of a partnership and the

partnership invests in a foreign investment entity. In these circumstances, the exempt taxpayer's share of the partnership's income or loss is computed without regard to new sections 94.1 and 94.2. For further details on the application of section 94.2 to partnerships, see the commentary on new subsections 94.2(6) to (8).

This amendment applies to fiscal periods of partnerships that begin after 2001.

Agreement or Election of Partnership Members

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended so that it applies for the purposes of elections under

- new paragraph (*c*) of the description of A in subsection 94.1(5) (election by taxpayer to use discretionary deductions on behalf of FIE);

- new subsection 94.1(12) (election to treat foreign affiliate as controlled foreign affiliate);

- new subsection 94.1(4) (election to have accrual regime for foreign investment entities apply);

- new subparagraph (i) of the description of D in paragraph 94.2(4)(*a*) (election to recognize positive deferral amount before year of disposition); and

- new paragraph 95(2)(*g*.3) (elections and designations for the purposes of computing foreign accrual property income).

This amendment applies to fiscal periods of partnerships that begin after 2001.

Application of Foreign Partnership Rule

ITA
96(9)

Subsection 96(8) of the Act provides rules that apply where, at a particular time, a Canadian resident becomes a member of a partnership, or a person who is a member of such a partnership becomes a resident of Canada. Where, immediately before the particular time no member of the partnership was resident in Canada, these rules apply in computing the income of the partnership for fiscal periods ending after the particular time. In general terms, the rules in subsection 96(8) are designed to prevent losses accrued while a partnership had no Canadian resident partners from being used to reduce Canadian income tax liabilities.

Subsection 96(9) provides that, where one of the main reasons that there is a member of the partnership who is resident in Canada is to avoid the application of subsection 96(8), that member will, for the purpose of applying subsection 96(8), be considered not to be resident in Canada.

Subsection 96(9) is amended to provide an explicit look-through rule for the purposes of subsection 96(8) so that members of partnerships may be identified through one or more tiers of partnerships which are members of other partnerships. Amended subsection 96(9) is consistent with new subsection 94.2(8).

This amendment applies to partnership fiscal periods that begin after June 22, 2000.

Clause 14

Trusts and their Beneficiaries

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

ITA
104(4.1)

New subsection 104(4.1) of the Act provides that, for the purposes of the 21-year deemed disposition rule in subsection 104(4), a property's status as capital property is determined without reference to new subparagraph 39(1)(*a*)(ii.3) and new section 94.2. The latter provisions have the effect of providing that interests in foreign investment entities to which subsection 94.2 applies are not classified as capital property. In the event that such an interest is deemed to have been disposed of because of the application of subsection 104(4), there is a recognition of the "deferral amount" pursuant to subsection 94.2(4).

This amendment applies to trust taxation years that begin after 2001.

ITA
104(6)

Subsection 104(6) of the Act generally permits a trust to deduct, in computing income for a taxation year, any income payable to a beneficiary under the trust.

Subsection 104(6) is amended so that it is expressly subject to subsection 104(7) and new subsection 104(7.01).

This amendment applies to trust taxation years that begin after 2001. In addition, this amendment will apply to trust taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in

which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

ITA
104(7.01)

Subsection 104(6) generally permits a trust to deduct, in computing income for a taxation year, an amount not exceeding the portion of its income for the year that "becomes payable" in the year to a beneficiary. (Because of subsection 104(24), trust income is deemed not to have "become payable" in the year to a beneficiary unless it is paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of the amount.)

New subsection 104(7.01) of the Act restricts the amount that a trust, that would otherwise be non-resident but is deemed by subsection 94(3) to be resident in Canada (referred to in this commentary as a "subsection 94(3) trust"), can deduct under subsection 104(6) in computing its income in the event that the trust has Canadian-source income and makes distributions to beneficiaries not resident in Canada.

In effect, subsection 104(7.01) acts as a proxy for taxes under Parts XII.2 and XIII of the Act in connection with Canadian-source income that has become payable by a subsection 94(3) trust to its non-resident beneficiaries.

New subsection 94(3) deems a trust to which it applies to be resident in Canada for certain purposes, not including Part XII.2. Accordingly, a trust that is resident in Canada solely because of the deeming provision in subsection 94(3), would generally be non-resident for purposes of Part XII.2. Because of an existing exemption for non-resident trusts in Part XII.2, a tax under that Part does not apply to such a trust.

A subsection 94(3) trust is also exempt from Part XIII withholding obligations on Canadian-source income that becomes payable in the year by a resident of Canada to non-resident persons because these subsection 94(3) trusts are not treated by new subsection 94(3) as resident in Canada for this purpose.

However, to ensure that subsection 94(3) trusts are not inappropriately used to distribute Canadian-source income free of tax to non-resident beneficiaries, subsection 104(7.01) limits the amount of any trust deduction under subsection 104(6) for such distributions, thereby ensuring the income is subject to Part I tax in the trust.

(It should also be noted that Canadian residents that pay an amount to a subsection 94(3) trust are still liable for a withholding obligation under section 215 of the Act notwithstanding that the trust itself is exempt from Part XIII tax. This is because new paragraph 94(4)(*b*) provides that the deemed Canadian residence under subsection 94(3) does not apply for the purposes of determining withholding tax under section 215. The Canada Customs and Revenue Agency will hold the withholding taxes paid and apply them on account of the trust's Part I tax liability. The existing provisions of the Act do not expressly give a Part XIII exemption in this regard to trusts that are subject to existing subsection 94(1). Instead, existing subparagraph 94(1)(*c*)(ii) allows a tax credit to be claimed by those trusts under section 126 in connection with Part XIII tax on payments made to those trusts.)

As mentioned above, subsection 104(7.01) reduces the maximum deduction under subsection 104(6). More specifically, the amount by which the maximum deduction under subsection 104(6) for a taxation year is reduced under subsection 104(7.01) is equal to the lesser of two amounts:

- the total of

  - the trust's "designated income" for the year (as defined in Part XII.2), which essentially consists of taxable capital gains from taxable Canadian property and income from businesses carried on in Canada, and

  - 50% of all amounts paid or credited in the year to the trust that would, disregarding express provisions to the contrary in the Act, be subject to Part XIII tax; and

- the portion of the maximum deduction under subsection 104(6) that is attributable to amounts that "become payable" (determined with reference to subsection 104(24)) in the year to partnerships (other than Canadian partnerships, referred to in section 102) or other non-resident entities.

The example below illustrates the operation of new subsection 104(7.01).

Example

1. *Trust X is an offshore trust established by Stefan, a long-term resident of Canada. The primary beneficiaries under the trust are Linda (a resident of Canada) and Bart (a resident of the United States).*

2. *Trust X receives $1,600 of income in its 2002 taxation year. This income consists of $400 of taxable dividends received from a taxable Canadian corporation. The remaining $1,200 of income is from other sources, none of which is "designated income" (as defined in Part XII.2) of the trust.*

3. *$1,250 of Trust X's income for 2002 is made payable in the year to Bart. The remaining $350 of the trust's income is made payable in the year to Linda.*

4. *Trust X is assumed to have designated the $400 of taxable dividends under subsection 104(19). (Where a designation under subsection 104(19) is available and the designation is made, the designated portion of the dividend income of the trust will, for the purposes of the Act (other than Part XIII), maintain its character, as dividend income, in the hands of the beneficiary.)*

Results

1. *Because Trust X has a resident contributor at the end of its 2002 taxation year, the trust is deemed by new subsection 94(3) to be resident in Canada for the purposes of computing its income.*

2. *Before taking into account any deduction under subsection 104(6), Trust X's income is $1,600. Note that the $400 in dividends are included in computing the trust's income under 104(19).*

3. *Before taking into account new subsection 104(7.01), the maximum deduction under subsection 104(6) is also $1,600.*

4. *Because of subsection 104(7.01), the maximum deduction under subsection 104(6) is reduced to $1,400 (i.e., $1,600 minus the lesser of: (nil + (50% x $400)) and ($1600 - $1,250)).*

5. *Assuming that the trust claims a deduction of $1,400 under subsection 104(6), the trust would consequently have income of $200. If a tax rate of 50% were assumed, the trust would be liable for Canadian income tax of $100. Note that the trust is exempt from having to collect a Part XIII tax in respect of the distribution to Bart, because the trust is not treated by new subsection 94(3) as resident in Canada for this purpose. Disregarding this exemption, the Part XIII tax that would have had to have been collected by the trust in respect of the distribution to Bart would also have been $100 (i.e., 25%[28] of $400).*

New subsection 104(7.01) applies to trust taxation years that begin after 2001. In addition, this amendment will apply to trust taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

ITA
104(21.3)

Subsection 104(21.3) of the Act defines the expression "net taxable capital gains". The expression is used in subsections 104(21) and (21.2), which permit a trust to flow its taxable capital gains realized in a year through to a beneficiary who has received a portion of the trust's income for the year. The trust can flow through its taxable capital gains to beneficiaries only to the extent of its net taxable capital gains for the year.

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[28] Note that the Part XIII tax rate in this case would remain as 25% under the Canada/U.S. tax treaty. This is because a designation of dividend income of the trust under subsection 104(19) of the Act would not result in that income being considered to be dividend income for the purposes of Part XIII of the Act.

Under subsection 104(21.3), the net taxable capital gains of a trust for a taxation year equals the amount, if any, by which its total taxable capital gains for the year exceeds the total of two amounts:

- its total allowable capital losses for the year, and
- the amount deducted by it under paragraph 111(1)(*b*) in computing its taxable income for the year (i.e., deduction of carried-over net capital losses for preceding years and for the three following years).

Subsection 104(21.3) is amended so that allowable business investment losses (ABILs) are disregarded for the purpose of the first of the two amounts. Accordingly, ABILs will not result in a reduction of taxable capital gains that may be flowed through to beneficiaries under trusts and against which allowable capital losses can be claimed.

This amendment applies to trust taxation years that begin after 2000.

ITA
104(24)

The determination of when an amount becomes payable in a taxation year is relevant for a number of purposes, including the determination of the amount deductible under subsection 104(6) of the Act. Under subsection 104(24), an amount (e.g., income payable to a beneficiary) is deemed not to have become payable in the year to a beneficiary unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of the amount.

Subsection 104(24) is amended so that it also applies for the purposes of paragraph (*h*) of the definition "exempt foreign trust" in subsection 94(1), paragraph (*c*) of the definition "specified charity" in subsection 94(1) and new subsection 104(7.01). For more detail, see the commentary on those provisions.

This amendment applies to trust taxation years that begin after 2001. In addition, this amendment will apply to trust taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in

which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 15

Income of a Trust in Certain Provisions

ITA
108(3)

Subsection 108(3) of the Act provides that, for the purposes of the definition "income interest" in subsection 108(1), the income of a trust is its income computed without reference to the provisions of the Act.

Subsection 108(3) is amended so that the rule described above also applies for the purposes of the definition "exempt foreign trust" in new subsection 94(1).

This amendment applies to taxation years that begin after 2001. In addition, this amendment will apply to trust taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 16

Deduction in Respect of Dividend Received from Foreign Affiliate

ITA
113

Subsection 113(1) of the Act permits a resident corporation to deduct specified amounts in respect of dividends received from a foreign affiliate out of the exempt, taxable and pre-acquisition surplus of the foreign affiliate. The amounts so deductible are determined largely with reference to Part LIX of the *Income Tax Regulations*. The deductions under paragraphs 113(1)(*b*) and (*c*) with regard to

dividends out of taxable surplus are also determined with reference to the resident corporation's "relevant tax factor".

Subsection 113(1) is amended to explicitly link the "relevant tax factor" to the resident corporation receiving the dividends and the taxation year in which the dividends are received. This is consistent with the more explicit definition of "relevant tax factor" described above in the commentary on subsection 95(1).

This amendment applies after 2001.

Clause 17

Part-year Residents

ITA
114

Section 114 of the Act provides rules for computing the taxable income of an individual who is resident in Canada for a period or periods in a taxation year, and is non-resident for the rest of the year.

Section 114 is amended so that it is subject to paragraph 94.2(5)(*c*), a rule that applies in connection with interests in foreign investment entities that are subject to the mark-to-market regime under section 94.2. Paragraph 94.2(5)(*c*) is, however, only relevant to individuals who cease to be, and later become, resident in Canada in the same taxation year. For further detail, see the commentary on new subsection 94.2(5).

This amendment applies to the 2001 and subsequent taxation years.

Clause 18

Tax Payable by *Inter Vivos* Trust

ITA
122(2)(*d*.1)

Subsection 122(1) of the Act provides that, instead of graduated income tax rates, *inter vivos* trusts are generally subject to top marginal rates of income tax on their undistributed income. Subsection 122(2) permits graduated income tax rates for certain *inter vivos* trusts established before June 18, 1971. One of the conditions for an *inter vivos* trust continuing to qualify for graduated income tax rates is that it not receive any gifts after June 18, 1971.

Paragraph 122(2)(*d*.1) is introduced so that the graduated income tax rates cease to apply to a trust in the event that, after June 22, 2000, a "contribution" is made to the trust. For this purpose, the expression "contribution" is defined in new section 94.

This amendment applies to taxation years that begin after 2001.

Clause 19

Exempt Corporations

ITA
149(10)(*c*)

Subsection 149(10) of the Act applies where, at a particular time, a corporation becomes or ceases to be exempt from tax under Part I on its taxable income (otherwise than by reason of the exemption for certain insurers in paragraph 149(1)(*t*)). A new taxation year is considered to start at the particular time and the corporation's properties are deemed to have been disposed of at fair market value and reacquired at the particular time for the same amount.

Paragraph 149(10)(*c*) provides that the corporation is, for specified purposes in the Act, treated as a new corporation. One of the specified purposes is with regard to the investment tax credit regime set out in subsections 127(5) to (26).

Paragraph 149(10)(*c*) is amended to make a reference to additional rules for the investment tax credit that are set out in subsections 127(27) to (35). This amendment is consequential on the earlier enactment of these subsections.

Paragraph 149(10)(*c*) is also amended so that it also applies for the purposes of sections 94.1 to 94.3 (foreign investment entities). For example, a corporation's "deferral amount" (as defined in new subsection 94.2(1)) in respect of any interest it holds in a foreign investment entity is determined without reference to taxation years that occurred before the corporation's change of status. This will typically result in a nil deferral amount for the corporation.

These amendments apply to corporations that, after 2001, become or cease to be exempt from tax on their taxable income under Part I of the Act.

Clause 20

Assessment and Reassessment

ITA
152(4)(*b*)(vi)

In general terms, subsection 152(4) of the Act provides that the Minister of National Revenue may not reassess tax payable by a taxpayer for a taxation year after the normal reassessment period for the taxpayer in respect of the year unless certain conditions described in paragraph 152(4)(*a*) or (*b*) have been met. Subparagraph 152(4)(*b*)(vi) allows the Minister to reassess a taxpayer within 3 years after the end of the normal reassessment period for the taxpayer in respect of the year where the reassessment is made in order to give effect to the application of subsection 118.1(15) or (16) of the Act.

Subparagraph 152(4)(*b*)(vi) is amended to also allow the Minister to reassess a taxpayer within three years after the end of the normal reassessment period where the reassessment is made in order to give effect to the application of new subsection 94(9) or (11). For more detail, see the commentary on new subsections 94(9) and (11).

This amendment applies to taxation years that begin after 2001. In addition, this amendment will apply to a taxpayer's taxation years that begin in 2001 if new section 94 of the Act applies in respect of the taxpayer for those taxation years because a trust, created in 2001, has elected in writing (by filing the election with the Minister on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clauses 21 and 22

Penalties

ITA
162 and 163

Subsection 162 and 163 of the Act impose penalties for infractions such as failing to provide certain information on a return, failing to file a return for a taxation year, and making false statements on a return.

ITA
162(10.1) and (10.11)

Subsection 162(10.1) of the Act imposes a penalty on any person or partnership that is more than 24 months late in filing an information return that the person or partnership was required to file under any of sections 233.1 to 233.4. (This penalty applies in addition to the penalties imposed under subsections 162(7) and (10).)

The penalty imposed under subsection 162(10.1) with respect to a particular information return is equal to a specified amount less the amount of the penalties imposed under subsections 162(7) and (10) with respect to the return. The specified amount with respect to an information return for a trust required to be filed by a person or partnership under section 233.2 is equal to 5% of the total fair market value of any property transferred or loaned to the trust that, if no other loan or transfer were taken into account, would have imposed an obligation on the person or partnership to file the return.

Subsection 162(10.1) is amended, as a consequence of amendments made to section 233.2, by changing the manner in which the specified amount is determined. The specified amount is now to be determined with reference to the fair market value of "contributions" made by the person or partnership to the trust.

New subsection 162(10.11) provides that, for the purpose of the calculation in subsection 162(10.1), the definitions and rules in subsections 94(1) and (2) generally apply. Subsection 162(10.11) is similar to amended subsection 233.2(2), described in greater detail in the commentary below.

These amendments apply to returns in respect of taxation years that begin after 2001. In addition, these amendments will apply to returns in respect of taxation years that begin in 2001 if the return relates to a trust created in 2001 that has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

ITA
162(10.3), 162(10.4), 163(2.6) and 163(2.91)

Existing paragraph 94(1)(*d*) of the Act provides for non-resident trusts to be treated as foreign affiliates. It is being repealed as a consequence of the introduction of new rules for non-resident trusts in section 94. Subsections 162(10.3) and (10.4) are rules that affect the calculation of penalty tax in respect of a person's or partnership's failure to file a return in respect of a foreign affiliate.

Subsections 163(2.6) and (2.91) are similar provisions that affect the calculation of penalty tax in respect of false statements and omissions in such a return.

Subsections 162(10.3) and 163(2.6) are amended to reflect the changes to section 94 under which non-resident trusts are no longer treated as foreign affiliates. Subsections 162(10.4) and 163(2.91) are repealed for the same reason.

These amendments apply to returns in respect of taxation years that begin after 2001. In addition, these amendments will apply to returns

in respect of taxation years that begin in 2001 if the return relates to a trust created in 2001 that has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

ITA
163(2.4)(*b*) and (2.41)

Subsection 163(2.4) of the Act imposes a penalty on any person or partnership that, knowingly or under circumstances amounting to gross negligence, has made or has participated in, assented to, or acquiesced in, the making of a false statement or omission in a return required to be filed under any of sections 233.1 to 233.6. The penalty under paragraph 163(2.4)(*b*) relates to a return required to be filed under section 233.2. The existing penalty is the greater of $24,000 and 5% of the total fair market value of the property that the person or partnership loaned or transferred to the trust that gave rise to the obligation to file.

Paragraph 163(2.4)(*b*) is amended as a consequence of changes made to the non-resident trust rules in section 94 and the annual reporting requirement in respect of non-resident trusts under section 233.2. Under amended section 233.2, a person is subject to the annual reporting requirement where the person makes a "contribution" to the trust.

Accordingly, amended paragraph 163(2.4)(*b*) provides for a penalty for a person equal the greater of $24,000 and 5% of a specified amount in respect of the return. The specified amount for a person is essentially equal to 5% of the fair market value of "contributions" made by the person. The specified amount is calculated in the same way as the specified amount under amended subsection 162(10.1) in respect of late-filed returns. Under new subsection 163(2.41), the definitions and rules in subsections 94(1) and (2) generally apply. Subsection 163(2.41) is similar to amended subsection 233.2(2), described in greater detail in the commentary below.

These amendments apply to returns in respect of taxation years that begin after 2001. In addition, these amendments will apply to returns in respect of taxation years that begin in 2001 if the return relates to

a trust created in 2001 that has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 23

Foreign Reporting Requirements

ITA
233.2

Existing section 233.2 of the Act requires certain persons who have made transfers or loans to a "specified foreign trust", or to a non-resident corporation that is a controlled foreign affiliate of such a trust, to file annual information returns with respect to the trust. A "specified foreign trust", as defined in subsection 233.2, includes a trust with a "specified beneficiary" resident in Canada. As defined in subsection 233.2(1), a "specified beneficiary" is generally any beneficiary under the trust with the exception of persons listed in subparagraphs (*a*)(i) to (x) of the definition. For a return to be required to be filed as a consequence of a transfer or loan, it is necessary to have a "non-arm's length indicator", as set out in subsection 233.2(2), apply in respect of the transfer or loan. One of the cases where a "non-arm's length indicator" applies in respect of a transfer to a trust is where the transferor is a "specified beneficiary" under the trust. Subsection 233.2(3) provides a look-through rule so that, where a partnership transfers property, it is considered to have been transferred by members of the partnership.

New section 94 sets out new rules governing the taxation of non-resident trusts. In order to be consistent with the new rules:

- the definitions "specified beneficiary" and "specified foreign trust" in section 233.2 are repealed,

- there is no longer a requirement for a "non-arm's length indicator", so the existing rule in subsection 233.2(2) is repealed,

- except as described below, the definitions and rules of application in subsections 94(1) and (2) apply because of amended subsection 233.2(2), and

- there is no longer a requirement for an explicit look-through rule for partnerships in section 233.2, given that the rule in paragraph 94(2)(*o*) applies because of amended subsection 233.2(2). Consequently, subsection 233.2(3) is repealed.

Under amended subsection 233.2(4), reporting will generally be required for a taxation year whenever a "contribution" has been made by a person resident in Canada to a non-resident trust at or before the end of the year. Because of amended subsection 233.2(2), the expression "contribution" generally carries the same meaning as in new section 94 with most of the same exceptions for "arm's length transfers" contained in the definition of that expression in subsection 94(1). However, the exception contained in paragraph (*e*) of that definition (transfers or loans generally not undertaken to allow for the conferral of benefits on non-arm's length persons) does not give rise to an exception to the obligations for reporting under subsection 233.2(4). It should be noted that amended subsection 233.2(2) also applies for the purpose of new paragraph 233.5(*c*.1).

New subparagraph 233.2(4)(*b*)(ii) sets out a list of persons for whom reporting obligations are not imposed. This list is consistent with the list of beneficiaries who are not treated as "specified beneficiaries" under the existing rules in section 233.2.

Amended subsection 233.2(4) of the Act also exempts contributors from filing information returns with regard to trusts described in paragraphs (*c*) to (*j*) of the new definition "exempt foreign trust" in subsection 94(1). For more detail in this regard, see the commentary on that definition.

These amendments apply to returns in respect of taxation years that begin after 2001. In addition, they apply to returns in respect of taxation years that begin in 2001 if the return relates to a trust created in 2001 that has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

ITA
233.2(4.1)

New subsection 94(3) of the Act provides that, where a non-resident trust has a resident contributor or resident beneficiary at the end of the trust's taxation year, the trust is generally taxed on its income in Canada for the year as if the trust were resident in Canada. However, the deeming provisions in subsection 94(3) apply only to arrangements that are considered to be trusts for Canadian income tax purposes. In some cases, there may be doubt as to whether a given arrangement is a trust for Canadian income tax purposes.

New subsection 233.2(4.1), in combination with new subsection 233.2(4), imposes a filing obligation on contributors to certain entities or arrangements in respect of which reporting is not otherwise required. One of the key objectives of subsection 233.2(4.1) is to ensure that claims that section 94 does not apply can be reviewed by the CCRA.

More specifically, new subsection 233.2(4.1) applies where property has, directly or indirectly, been transferred or loaned by a person to be held

- under an arrangement governed by laws that are not laws of Canada or a province, or

- by a non-resident entity (as defined in subsection 94.1(1)).

The person must, where certain additional conditions are satisfied, file the information return referred to in amended subsection 233.2(4).

New subsection 233.2(4.1) provides that, except as the Minister of National Revenue otherwise permits in writing, the person has obligations under amended subsection 233.2(4) if all of the following conditions are satisfied:

- the transfer or loan is not an arm's length transfer (within the meaning that would be assigned by the definition "arm's length transfer" in subsection 94(1) if that definition were read without reference to paragraph (*e*) of that definition);

- the transfer or loan is not solely in exchange for property that would be described in paragraphs (*a*) to (*i*) of the definition "specified foreign property" in subsection 233.3(1) if that definition were read without reference to paragraphs (*j*) to (*q*) of that definition;

- the entity or arrangement is not a trust in respect of which the person would, without reference to subsection 233.2(4.1) and the explicit exemptions for filing returns contained in subsection 233.2(4), be required to file an information return for a taxation year that includes that time; and

- the entity or arrangement is, for a taxation year or fiscal period that includes that time, not

  (i) an exempt foreign trust (as defined in subsection 94(1)),

  (ii) a foreign affiliate in respect of which the person is a reporting entity (as defined in subsection 233.4(1)), or

  (iii) an exempt trust (as defined in subsection 233.2(1)).

Where the above conditions are satisfied, the person's obligations under subsection 233.2(4) and related provisions are determined as if:

- the transfer were a contribution to which paragraph 233.2(4)(*a*) applied;

- the entity or arrangement were a trust not resident in Canada throughout the calendar year that includes the time of the transfer or loan; and

- the taxation year of the entity or arrangement were that calendar year.

These amendments apply to returns in respect of taxation years that begin after 2001. In addition, they apply will apply to returns in respect of taxation years that begin in 2001 if the return relates to a trust created in 2001 that has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending

legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 24

Returns in Respect of Foreign property

ITA
233.3

Section 233.3 of the Act provides reporting requirements in respect of foreign property. In general terms, it provides that certain taxpayers resident in Canada and certain partnerships must file an information return with respect to their "specified foreign property" if the total cost amount of such property exceeds $100,000. For this purpose, "specified foreign property" (as defined in subsection 233.3(1)) includes an interest in a non-resident trust or a trust that would be non-resident were it not for section 94. It does not include an interest in a non-resident trust that was not acquired for consideration by the person or partnership.

Paragraph (*d*) of the definition "specified foreign property" is amended by changing a cross-reference to section 94 to a cross-reference to new subparagraph 94(3)(*a*)(iii). This amendment is consequential on amendments to section 94. As a result, interests in trusts deemed to be resident of Canada because of section 94 are "specified foreign property" unless otherwise expressly excluded.

Paragraph (*d*.1) of the definition is introduced so that specified foreign property includes an interest in an insurance policy issued by a non-resident insurer, if the mark-to-market regime in section 94.2 applies in respect of the interest. New paragraph (*d*.1) of the definition applies to returns for taxation years that begin after 2001. For further detail in this regard, see the commentary on new subsection 94.2(10).

Paragraph (*l*) of the definition is repealed to eliminate a reference to trusts that are treated as foreign affiliates. This reference is no longer necessary in light of new subsection 94(1), under which non-resident trusts are no longer treated as foreign affiliates.

Paragraph (*m*) of the definition is amended so that the exclusion for non-resident trusts that applies with regard to interests not acquired for consideration also applies to trusts that are deemed by subsection 94(3) to be resident in Canada. This amendment is made for consistency.

Except as indicated above, these amendments generally apply to interests in a trust held in taxation years of the trust that begin after 2001. In addition, amended paragraphs (*d*) and (*m*) of the definition "specified foreign property" and the repeal of paragraph (*l*) of that definition will apply to interests in a trust for the trust's taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 25

Returns Respecting Foreign Affiliates

ITA
233.4(1) and (2)

Section 233.4 of the Act provides reporting requirements in respect of foreign affiliates. In general terms, it provides that taxpayers resident in Canada (or certain partnerships) of which a non-resident corporation or non-resident trust is a foreign affiliate must file an information return in respect of the affiliate.

Subsections 233.4(1) and (2) are amended to eliminate references to foreign affiliates that are non-resident trusts. These references are no longer necessary in light of new subsection 94(1), under which non-resident trusts are no longer treated as foreign affiliates.

These amendments apply to trust taxation years and fiscal periods that begin after 2001. In addition, they apply to taxation years and fiscal periods that begin in 2001 if the years or fiscal periods relate to a trust the taxation year of which begins in 2001, the trust was created in 2001 and the trust has elected in writing (by filing the election

with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 26

Due Diligence Exception

ITA
233.5

Section 233.5 of the Act provides that, where specified conditions set out in paragraphs 233.5(*a*) to (*d*) are met, information required in a return filed under section 233.2 or 233.4 does not include information that is not available to the person or partnership required to file the return. In the case of a return required to be filed by a person or partnership under section 233.2, paragraph 233.5(*c*) provides that it must be reasonable for the person or partnership to expect, at the time of each transaction entered into by the person or partnership after March 5, 1996 that either gives rise to the requirement to file the return or that affects the information to be reported in the return, that sufficient information would be available to the person or partnership to comply with section 233.2.

Paragraph 233.5(*c*) is amended so that it applies only in connection with transactions entered into before June 23, 2000 that gave rise to the requirement to file a return for a taxation year of the trust that began before 2002. In connection with trust returns required to be filed for trust taxation years that began before 2002, it must be reasonable for the person or partnership to expect that sufficient information would have been available to the person or partnership to comply with section 233.2 if the proposed amendments to section 94 were not taken into account.

Paragraph 223.5(*c*) is also amended so that it does not apply to returns required to be filed under section 233.4. It is replaced in this respect by new paragraph 233.5(*c*.2), without any change in the specified conditions for such returns.

Paragraph 233.5(*c*.1) is introduced in connection with returns required to be filed under section 233.2 by a person or partnership for a taxation year of the trust that begins after 2001. Where "contributions" (determined with reference to subsection 233.2(2), referred to in the commentary above) are made after June 22, 2000, relief under section 233.5 is available only if it was reasonable for the person or partnership to expect, at the time of each such contribution that either gives rise to the requirement to file the return or that affects the information to be reported in the return, that sufficient information would be available to the person or partnership to comply with section 233.2.

These amendments apply to trust taxation years and fiscal periods that begin after 2001. In addition, these amendments will apply to trust taxation years that begin in 2001 if the trust was created in 2001 and has elected in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001.

Clause 27

Definitions

ITA
248(1)

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

"cost amount"

This definition is used throughout the Act, particularly in provisions relating to the transfer of properties to and from corporations, trusts and partnerships.

New paragraph (*c*.2) of the definition provides that, where a cost of property to a taxpayer is determined as of any time under new

subsection 94.2(12), that cost is also the "cost amount", under subsection 248(1), of the property to the taxpayer at that time.

This amendment applies after 2001.

"inventory"

A taxpayer's "inventory" is generally described in subsection 248(1) of the Act as a description of property the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year. Rules for "inventory" in section 10 and elsewhere in the Act affect the calculation of a taxpayer's income from business.

The definition "inventory" is amended to exclude descriptions of property the disposition of which is subject to the application of subsection 94.2(3) of the Act.

This amendment applies to fiscal periods that begin after 2001.

"foreign accrual property income"

The definition "foreign accrual property income" is included in subsection 248(1) so that the definition of this expression in section 95 of the Act applies for the purposes of the Act.

This amendment applies after 2001.

"non-discretionary trust"

The definition "non-discretionary trust" is included in subsection 248(1) so that the existing definition of the expression in subsection 17(15) applies for the purposes of the Act. The expression is used in the definition "foreign investment entity" in new subsection 94.1(1).

This amendment applies after 2001.